



REPORT
OF THE
TAXATION ENQUIRY COMMISSION



1953-54

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GOVERNMENT OF INDIA

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SECTION I

REPLIES OF CHAMBERS OF COMMERCE



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NOTE.—The full lists of Chambers of Commerce which sent replies to the Questionnaire of the Taxation Enquiry Commission is given in Appendix B of Part I of this Volume.

CONTENTS

*Replies of Chambers of Commerce and other organisations to the Questionnaire of the Taxation Enquiry Commission.**

SECTION

PAGES

I. REPLIES OF CHAMBERS OF COMMERCE†—

Bengal Chamber of Commerce and Industry, Calcutta	1
Bengal National Chamber of Commerce, Calcutta	30
Bharat Chamber of Commerce, Calcutta	55
Bombay Chamber of Commerce, Bombay	92
Hindustan Chamber of Commerce, Madras	120
Indian Merchants Chamber, Bombay	125
Madras Chamber of Commerce, Madras	173
Merchants' Chamber, U. P., Kanpur	187

II. REPLIES OF ORGANISATIONS OTHER THAN CHAMBERS OF COMMERCE—

ANDHRA :—

Bharat Kisan Sammelan, Niduprolu (Camp)	216
---	-----

ASSAM :—

Assam Oil Company Ltd., Digboi	219
--	-----

BOMBAY :—

Ahmedabad Millowners' Association, Ahmedabad	224
All India Co-operative Union, Baroda	240
Banaskantha Jilla Khedut Mandal, Palampur	244
Bhal Nalkantha Khedut Mandal, Gundi	245
Bombay Co-operative Banks Association, Bombay	248
Bombay Shareholders' Association, Bombay 1	255
Federation of All India Local Authorities, Bombay 18	262
Federation of Electricity Undertakings of India, Bombay	267
Federation of Motor Transport Associations, Bombay 7	275
Indian Banks Association, Bombay 1	277
Millowners' Association, Bombay 1	280
Stock Exchange, Bombay	311
Tax-payers' Association of India Ltd., Bombay 1	403
Western India Automobile Association, Bombay 1	425

MADRAS :—

Association of Mutual Life Offices in India, Udipi	427
United Planters' Association of South India, Nilgiris	430

WEST BENGAL :—

Calcutta Stock Exchange Ltd., Calcutta	434
Employers' Association, Calcutta 16	441

DELHI :—

Delhi School of Economics, Delhi 9	472
Institute of Chartered Accountants of India, New Delhi 1	474
S. Vaidyanathan & Co., Delhi	480

* NOTE.—The full lists of individuals and organisations which sent memoranda to the Taxation Enquiry Commission are published at pp. 301-315 of Part I of this Volume (Appendices A and B). Due to lack of space it has been possible to print only a few of these replies here.

†Replies of (i) Federation of Indian Chambers of Commerce and Industry and (ii) Associated Chambers of Commerce of India, are published in Part I of this Volume.

The Bengal Chamber of Commerce and Industry, Calcutta.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART I.—THE TAX SYSTEM

GENERAL.

Question 1.—*What, in your opinion, should be the objectives of a sound tax policy?*

In the opinion of the Chamber, the main objective of a sound taxation policy is fiscal effectiveness and efficiency; in other words, the collection within the limits of State social and economic policies, of finance sufficient for the government of the country, its security, efficient administration and development. In present and foreseeable conditions in India, however, fiscal efficiency does not cover only the yield of taxation but, to an increasing degree, involves considerations of the effect of taxation on the future level of enterprise. In the opinion of the Chamber, a sound taxation policy is one which while yielding adequate returns in the present at the same time gives encouragement to the rapid development of enterprise in the future. These objectives are regarded as essential; the others referred to are incidental and are to a large extent attempts to implement through the taxation system social or economic policies which as such have no direct connection with it.

Question 2.—*What should be the place in such a policy of the following objectives?*

- (a) *Reduction in inequalities of income and wealth.*
- (b) *Encouragement of incentive to work to save and to invest.*

The Bengal Chamber is of the opinion that it is impossible to consider objectives (a) and (b) independently as the one has a direct bearing on the other. It is, therefore, proposed that (a) and (b) should be considered together.

Having accepted a mixed economy as the most suitable for the development of India during the currency of the Five Year Plan, Government have placed on the private sector the onus of providing Rs. 233 crores for new industrial investment and Rs. 150 crores for making good arrears in depreciation. If the private sector is to play its part to this extent in furthering the development of the country Government will, it is contended, have to approach the whole problem of taxation with the minimum of political idealism and in a bold and realistic manner.

The problem that is uppermost in everybody's mind in India today is that of unemployment. In a country of 360 million, with an annual increase in population of 4½ million, it is necessary that the tax policy should be so devised as to create conditions whereby the increased population will be readily found employment. India is and will remain predominantly an agricultural country but already the pressure of man upon the soil has become such that, without a sustained improvement in agricultural output, it cannot produce enough food to satisfy even the regrettably low standards at present accepted by its people. The remedy lies in rapid expansion of industry.

The view is held in some quarters that redistribution of wealth is a solution to the problem of mass poverty, but this ignores the truth that wealth can create wealth, whereas poverty breeds only poverty. And it is at this point unfortunately that idealism and sound economic reasoning come to the parting of the ways. Taxation may well take away from the rich in India but it does not yet give to the poor, for no social services of any consequence are provided by the State and the development projects partly financed by taxation (which it may be argued will ultimately raise the standard of living of the poorest) are not yet in productive operation. The concept that wealth in the hands of an individual or a company is unjustifiable when so many others are facing poverty and distress is one that finds sympathy in some political circles, but it is submitted that such a view at this juncture in India's development is unrealistic. An examination of industrial development in highly industrialised countries goes to show that in nearly all cases industries have grown out of comparatively humble beginnings due to the foresight, courage and ability of comparatively few individuals. In nearly every instance expansion of such industries has been due to re-investment of profits which individuals and companies have been allowed to earn and retain, backed by the financial support of a public with an investible surplus which has had confidence in such leadership. That is the climate in which industrial development can make rapid advance, fresh wealth be created and employment found for men in all walks of life.

The Bengal Chamber feels that only by creating opportunities for employment can the standard of living

be raised and the objectives of the Five year Plan be achieved wherein 800,000 to 1,000,000 people are to be provided with new employment annually. If substantial industrial expansion can be achieved it will have an effect on agricultural output. The increase in earnings of those newly employed will create a purchasing power which should in turn stimulate the demand for agricultural products. It is submitted that the present taxation policy so far from encouraging this objective has since 1947 stultified it. The provisions of that year's budget, framed to meet particular circumstances, put a noose round the neck of India's industrial leaders, out of which have slipped only those who were prepared to play outside the rules. Today these are the only men who are in a position to make a substantial contribution in the private sector, but the question naturally arises whether the country's future in that sector will be best served if development in it is left exclusively to this section of industrialists, many of whom are in effect financiers and men with no intimate knowledge of industrial affairs.

There appear to be only two alternatives by which Government can achieve its object: a wide scale extension of Government participation in industry or an entirely fresh approach to the tax problem with a view to encouraging the best talents and enterprise which are available to the country in the private sector and which could serve it well if they are only allowed to function under conditions which make industrial expansion safely possible. For Government to adopt the first alternative would be unwise for many reasons. First of all the machinery of Government is too cumbersome to adapt itself easily to the quicker tempo of competitive industry. Then there is a great dearth of technical and administrative talent surplus to Government's primary responsibilities; and finally the totalitarian methods of other countries would hardly be acceptable to the India of today.

There remains therefore the other alternative, namely giving to the best elements in the private sector scope to work for the country's good as free as possible from Government intervention and with incentives proportionate to the risks that are inseparable from rapid industrial expansion. This could be quite simply achieved by suitable modifications in the present tax structure for both companies and individuals (accompanied by swifter and harsher penalties for evasion). The threat of the increase in population must be met, and the Chamber is emphatic that levelling down is not the answer; even complete re-distribution of wealth would bring such infinitesimal and momentary relief that this as an approach to the tax problem should be summarily discarded. Instead it is suggested that the Commission should seek ways and means of encouraging expansion in the private sector by designing a tax policy which will bring about a favourable climate for producing fresh wealth and fresh avenues of employment in a country in which there is no time for delay and in which should be no shirking a realistic approach.

(c) *Countering of inflationary and deflationary tendencies:*

Taxation policy is an instrument of only limited effectiveness in countering inflationary and deflationary tendencies, particularly in India where the total number of direct taxpayers is so small a proportion of the total population. It is uncertain, it is slow, and it is productive of inequity and anomalies. At a certain stage—and the Chamber believes this stage has already been reached—high rates of taxation imposed for the purpose of reducing inflation defeat their own objects, for not only do they discourage hard work and enterprise and thus accentuate the storage of goods which is one of the causes of inflation, but they promote irresponsible spending on the part of industry and encourage taxpayers to seek means of divesting themselves of taxable income. As a means of combating inflation or deflation therefore, taxation is an instrument which should be used with the greatest care and circumspection, and the Chamber considers that it is only in a state of great emergency that it should be so used. The great increases in personal and corporate taxation during the period 1940—1947 helped to keep a well-developed inflationary situation in India under control. Unfortunately the rates then imposed have since come to be regarded as the norm. In general and in normal circumstances the Chamber does not consider that this is an important objective of the tax system.

(d) *Maintenance of the external balance of the economy:*

The use of taxation for the maintenance of the external balance of the economy presumably involves the imposition of import and export duties. The

Chamber does not consider that Customs duties are an appropriate means of achieving a balance in external payments, for experience has shown that they are uncertain in their effects and indeed as often as not produce results which are entirely unlooked for and may well be contrary to those which it was intended to achieve. Commerce like nature abhors a vacuum and if attractive operations for trade present themselves, unscrupulous traders have not been slow to find some means of evading fiscal barriers that may be placed in their way. The export duties which were imposed on jute goods during the post-devaluation shortage illustrate the Chamber's contention that an impost which was introduced with the most laudable objects has not only failed to achieve those objects but has seriously damaged the present position and future of the jute trade which is the country's most important source of export earnings.

General.

Summing up its views on the objects of taxation specified in this question, the Chamber would say that, subject to the fulfilment of the basic objective of raising finance efficiently and with least pernicious effects, the encouragement of incentive to work, to save, and to invest should be a first charge upon taxation policy; that, subject to certain very severe limitations, the maintenance of the external balance of the economy can be partially regulated by fiscal measures; that, particularly in India, taxation is not an effective means of combating inflation or deflation; and that a reduction in inequalities of income and wealth by means of tax policy is a positive hindrance rather than an aid to the country's economic development and will eventually destroy the main source of revenue from direct taxation.

The Chamber's proposals for modifications in the tax system will be evident from its more detailed replies to later part of this questionnaire. Broadly, however, and in line with the views expressed above, the Chamber considers that the tax structure should be remoulded in two main ways:—

- (a) To promote industry, saving and investment, it is necessary to reduce the burden of taxation on industry and on those members of the professional, managerial and investing classes who form part of the middle and upper income groups;
- (b) To raise the finance required for the country's development plans, and to distribute the burden more equitably, it is necessary to cast the taxation net more widely and, in particular, and in the context of India's economic circumstances, to make an increased resort to indirect rather than direct taxation.

Question 2.—What criteria would you suggest for determining the equity of a tax system? How far is it possible to secure it in the Indian tax system?

Question 3.—Does the Indian tax system conform adequately to the principle of ability to pay or do you think an extension of this principle is desirable and practicable? If so, in what ways?

Question 4.—Differing views have been expressed on the extent to which the taxable capacity of various sections of the community has been used by the Indian tax system. What is your view on the subject?

Question 5.—The proportion of tax revenue to national income in India is considered small relatively to several other countries. Do you think this proportion can be raised, and, if so, what tax changes would you suggest for the purpose?

Question 6.—Do you think that the relative place of direct and indirect taxes in the Indian tax system is satisfactory?

Answer to Questions 2 to 6:

A taxation system is equitable if it ensures that those who benefit from public expenditure contribute to the funds which are available for that expenditure and that at the same time the burden of taxation takes reasonable account of capacity to pay. In the Chamber's opinion, the present system of taxation in India does not satisfy either of these criteria. A very large part of the public income from taxation is earmarked for development projects but the burden of taxation hardly touches those sections of the community who will derive the main benefits from these projects; on the contrary, the burden is concentrated on a relatively small class—the class which will receive least direct benefit from contemplated public expenditure. This no doubt conforms to a certain extent to the principle of assessing on the basis of ability to pay, but nevertheless the Chamber considers that the capacity to pay of the mass of the population is greatly underestimated. Further, with so large a population there can be a considerable extension of the field of taxation, the incidence of which on the individual would be negligible.

The Chamber considers that there is ample scope for extending the incidence of taxation; and it believes

that the means of achieving a wider application of the tax burden is a resort to increased indirect taxation as opposed to direct. In India, with its vast population and correspondingly vast consuming market, indirect taxation has the great virtue of enabling considerable sums to be raised by means of impositions which in themselves are relatively slight. Though the standard of living is still low by Western conditions, the money income of the masses has indubitably increased to a very large extent over the last decade, as witnessed by the increased consumption of consumer goods and the decrease in rural indebtedness. A few annas a month payable in indirect taxes would now-a-days mean little in the budget of the average individual.

Question 7.—Do you consider that non-tax revenues are likely, in future, to occupy a more important place than hitherto in the public revenues of India? If so, please state the sources of non-tax revenue you have in view and indicate to what extent they may be expected to contribute to the public exchequer.

The revenue accruing from sources other than taxation must obviously depend on the extent of State participation in commerce, in industry and in public utilities. It therefore raises questions of political and economic theory which do not properly come within the scope of an enquiry into taxation. The Chamber would make the obvious remark however that, as the field of State participation in all industry widens, so must the private sector diminish; and so consequently must private earnings decrease as a source of taxation revenue. To a large extent, therefore, an extension of State enterprise involves merely a process of transferring wealth from one hand to the other; the revenue accruing from the taxation of the private sector disappears and is replaced by the profits of State-managed enterprises.

The sources of non-tax revenue are well known: railways, the recently nationalised airways, the posts and telegraphs, hydro-electric schemes and Government projects such as the Sindri Fertiliser Factory. In the case of the more modern and recent of these, such as the hydro-electric projects, there is no doubt that in due course they will provide a solid and substantial source of revenue; in their initial stages, however, they must inevitably involve a liability rather than an immediately productive asset, and there must accordingly be a time lag between their commencement and their development into revenue-producing investments. The Chamber is unable to make an assessment of the extent to which these sources may in due course be expected to contribute to the public exchequer. It seems that in actual practice and for the reasons given in reply to Question 10 such contributions will be small.

Question 8.—Do you agree with the view that receipts from particular taxes should not, as a rule, be funded or earmarked for specific purposes?

Whatever may be the theoretical position, the Chamber considers that practical experience has shown that it is a mistake to earmark the receipts from particular taxes for specific purposes. The system is too open to abuse and in practice it is only too common for hard-pressed Governments to raid these funds and divert them from the specific purpose for which they were originally constituted. Generally speaking, therefore, the Chamber is opposed to the funding of tax receipts; and, if the practice must be resorted to, it should be only in special circumstances, it should be only after a very careful examination of the merits of the particular case involved, and it should be subject to a strict adherence to the principle that the funds must not be diverted from their original purpose.

Question 9.—Do you think that it is desirable, under certain conditions, to levy cesses for special purposes?

What has been said in the foregoing reply on the question of the funding of particular taxes also applies to a certain extent to the imposition of cesses for special purposes. In this instance, however, the objections are perhaps not so strong and, subject to their circumspect application and use, cesses can play a useful part. Unless strict control is applied, the imposition of cesses on an industry can become a penal burden. An example of the unbridled use of cesses is the situation in the coal industry where the following cesses and exise duties are imposed.

Cesses on Coal.

1. **Stowing Excise Duty.**—On coal and coke despatched by rail from India excluding Assam and Punjab:

(i) on coal and soft coke @ Rs. 0-6-0 per ton;
Rs. 0-9-0 from 10-5-51.

2. **Rescue Excise Duty.**—On coal and coke despatched by rail from Jharia and Raniganj fields=Rs. 0-0-2½ per ton.

3. **Labour Welfare Cess.**—31st December 1944. On coal and coke despatched by rail from whole of India=Rs. 0-6-0 per ton; i.e. 0-4-6 for Welfare Fund and 0-1-6 for Housing Board.

do. for 12 months from 1-4-1951. Rate altered to 0-4-8 for Welfare Fund and 0-1-4 for Housing Board.

Railway collecting fee from 1-4-47 standardised at 2 per cent. It was 5 per cent., 7½ per cent. and 3 per cent. in respect of 1, 2 and 3 above, previous to 1-4-47.

4. *Hazaribagh Mines & District Board*.—Cess Rs. 0-1-6 per ton of annual despatches of coal and coke from mines. (On average of 3 years.)

Rs. 0-1-0 of each rupee of annual nett profits on mines (on average of 3 years despatches) provided aggregate of local cess so levied does not exceed Rs. 0-3-0 per ton of annual despatches of coal and coke. (Bihar Cess Amendment) Act, 1936, Section 6B.

5. *Hazaribagh District*.—(Bihar Gazette Notification No. 3082, dated 22-3-50.)

(1950) Local Cess 0-2-0 per rupee of the annual value of lands.

6. *Jharia Mines Board of Health*.—Tonnage Cess: 1953-54—Rs. 4-6-0 per 100 tons of coal raised.

Royalty Cess: 1953-54—30 per cent. of the road cess payable.

7. *Jharia Road Board Cess*.—Rs. 0-1-0. Calculated at Rs. 0-1-0 per rupee on profits of the Colliery Company. The rate of cess of the despatches of coal and coke from mines under Section 1 on Section 6(c) on the Bihar Cess Amendment Act, 1936 for the ensuing year was fixed at 0-5 pies per ton.

8. *Manbhum District Cess*.—On tonnage—nil.

On profits—Rs. 0-1-0 per rupee on average nett profit of previous 3 years.

9. *Bengal—Primary Education Cess*.—Under the Bengal (Rural) Primary Education Act, 1930, Section 29(2), a cess of 10½ pies on each rupee of annual nett profits from mines and 15 pies on annual value of land. This is now extended to Burdwan.

10. *Jharia Water Board*.—Tonnage Cess—1952-53—Nine pies per ton on despatches of coal.

Royalty Cess—1952-53—Five per cent. on the amount of Royalty received during the calendar year 1951.

11. *Bihar District (excluding Hazaribagh)*.—(Bihar Gazette Notification No. 3401, dated 30-3-50.)

(1920) Local Cess 0-2-0 per rupee of the annual value of lands.

12. *Excise Duties under the Coal Mines (Conservation and Safety) Act, 1952* fixed with effect from 8th January 1952—

(1) 6 as. per ton on all coal including soft coke but excluding hard coke,

(2) 9 as. per ton on hard coke.

13. *Asansol Mines Board of Health*.—Tonnage Cess—1953-54—Rs. 4-0-0 per 100 tons of coal raised.

Royalty Cess—1953-54—fixed in due proportion to meet the expenditure of the Board for the year ending 31st March 1954.

Question 10.—*State undertakings, commercial, industrial, etc., are coming to play an increasingly important part in the economy of the country. Have you from the point of view of their significance as a source of revenue, actual or potential, any comments or suggestions to make on matters such as the further extension of State undertakings and their policies in regard to pricing, in so far as these may be relevant to tax policy?*

The remarks which the Chamber has made in reply to Question 7 have a bearing on this question. If there is an extension of State enterprise there may be a corresponding reduction in the taxable capacity of the private sector. Where State enterprises do operate, however, it is essential in the Chamber's opinion that they should be conducted according to the best and most sound commercial practices. Generally, State undertakings enjoy monopoly advantages and it is, therefore, often difficult to determine if they are economic or are efficiently run. Similarly, it is difficult to pass an opinion on their price policies, for as monopolists they are often in a position to charge prices which could not be maintained in a market subject to normal commercial competition. In view of these monopolistic advantages, the Chamber would suggest that, broadly speaking, State enterprises should not usually be expected to earn high profits and that if they do there are grounds for suspecting that their prices are too high and that they are in fact exploiting their monopoly at the expense of the consumer.

In fact in present circumstances the tendency is for rates to be kept on the low side in order to safeguard those concerned from the political odium of profiteering or of increasing the already high cost of living. Apart from this and in contrast with private enterprise where the willingness to assume responsibility and to take discriminating risks are highly valued and produce their own reward, State enterprise seems to be synonymous with a reluctance on the part of officials, particularly in the middle grades, to accept responsibility or use initiative. It is inherent in Government undertakings that they cannot be operated as economically or as

efficiently as commercial concerns. The executive handling Government money cannot act with the speed and freedom of his opposite number in commerce. Further, incentive is less. In the lower ranks the feeling of security in Government service and the knowledge that there is in the background a large purse from which losses can be recouped, the absence in the first place of the spur of competition, and in the second of the fear of unemployment all play their part in reducing the efficiency of State undertakings and neutralising their capacity to produce large profits for the State revenues. Finally, the development of State enterprise in this as in other countries seems inevitably to mean that the interests or industries concerned are to an increasing extent guided not by persons with expert knowledge of their specialised problems but by men who, quite apart from a total lack of practical experience in the particular directions concerned, have often little knowledge of other development projects.

These inherent disadvantages, which appear to be encountered wherever the policy of nationalisation is introduced, in the opinion of the Chamber make an extension of State undertakings which are an encroachment on the private sector undesirable not only on general grounds but particularly because they support the view that this section of enterprise is most unlikely to make any considerable contribution to the public revenues.

Question 11.—*Would you suggest that the net surplus earned by State undertakings should accrue to general revenues or be carried to a fund for financing projects of development or be re-invested in the undertakings concerned?*

In reply to the foregoing question, the Chamber has stated that State enterprises should conform to ordinary commercial practices. The first charge on their earnings should, therefore, be the maintenance of their capital intact and such reinvestment of profits as would be advisable in the case of a well-managed company in the private sector. The Chamber is opposed, however, to the idea that State enterprises should earn a substantial revenue which will supplement the State's income from taxation. If they do earn such a surplus, then, after their own depreciation, tax liabilities and re-investment requirements have been met, the balance should be carried to the general revenues; it should not be used as the basis of a special fund for financing other development projects.

Question 12.—*In examining the incidence of taxation on various classes of people, which of the following factors singly or in combination would you suggest as the basis of differentiation?*

- income,
- occupation,
- rural or urban residence?

Is there any other basis which may be considered?

The Chamber has not sufficient information of the specialised statistical nature required to reply usefully to this question.

Question 13.—*Do you think that the burden of the present tax system—Central, State and Local—is fairly distributed among—*

- Various classes of people?

As will be evident from earlier answers, the Chamber does not consider that the burden of taxation is fairly distributed among the population. The Chamber would in this respect remind the Commission of the analysis made by the Planning Commission in the First Five Year Plan (Chapter III, page 49) as follows:—

“About 28 per cent. of the total tax revenue comes from direct taxation which directly affects only about half of 1 per cent. of the working force . . . Another 17 per cent. is accounted for by import duties, a considerable part of which is derived from taxation of commodities like motor vehicles, motor spirit and oils, high quality tobacco, silk and silk manufactures, liquors and wines, etc., which affect but a relatively small section of the population. A large proportion of the excise duties on tobacco and cloth which yield about 8 per cent. of the total tax revenue is also probably paid by the limited number of consumers who use the better varieties . . . But if as much as one-third or more of total tax revenue is derived from certain limited strata of society, it implies that the burden of taxation spread over the rest of the community is correspondingly lighter . . .”

The largest sectors in the community—the agriculturist and the workers in industry—are practically exempt from taxation and almost the entire burden is inequitably concentrated on trade and industry and on the small section of middle-class society, professional workers, the managerial class, the business community, etc.

- Different States?

The Chamber has no opinion to express regarding the distribution of taxation among the States.

Question 14.—Have shifts in the distribution of income in the community in recent years altered the relative incidence of taxation on various classes of people? If so, to what extent?

The shifts in the distribution of income, which have not escaped the notice of the framers of the questionnaire and which have been referred to in the Chamber's reply to questions 2 to 6 above, have not been accompanied by appropriate alterations in the incidence of taxation, and this is the basis of the Chamber's contention that an extension of the field of taxation, particularly indirect taxation, is more than justified.

Question 15.—Do you think that the cost of compliance with tax regulations adds materially to the burden of taxation? If so, in respect of what taxes? Please give details.

The Chamber is emphatically of the view that compliance with tax regulations has added a quite disproportionate amount of work at all levels in industry and commerce. It has been found that the number of qualified Chartered Accountants whom it is now necessary to employ to supervise the compilation of tax returns has increased substantially since the war and there has been a proportionate increase in clerical and other staff directly engaged. Such staff is largely engaged in unproductive work and its employment has therefore added very substantially to business overheads without a corresponding advantage of any sort to the employer. The outstanding difficulties are caused by income tax returns, but sales tax is also responsible for a great deal of work and those industries which are the subject of excise duties face similar problems.

Question 16.—Do the benefits accruing from public expenditure have a bearing on a consideration of the burden of taxation? If so, how would you take this into account in considering the burden of Indian taxation?

The Chamber has already stated that those who benefit from public expenditure should also contribute to the funds available for that expenditure. Any useful examination of the burden of taxation must, therefore, necessarily involve an enquiry into the benefits conferred by public expenditure.

Question 17.—Do you think that the tax burden weighs particularly heavily on any individual industry or occupation? If so, please furnish the Commission with the evidence on which you rely?

It is the Chamber's contention that the tax burden weighs unduly heavily on industry and commerce as a whole, as opposed to the general population and in particular to the agricultural classes on whom the burden falls very lightly. Within industry there are undoubtedly certain sections which are penalised to a special degree. For instance, undertakings engaged in the exploitation of wasting assets, such as minerals, receive no special consideration, with the result that they have greater difficulty than other enterprises in maintaining their capital intact. Again, Government's practice of intervening in the affairs of an industry, by the imposition of special fiscal measures in order to meet a temporarily abnormal situation, frequently results in that particular industry being placed at a disadvantage while the additional impositions are in force; thus the exceedingly high export duties which were imposed on jute goods during the post-devaluation shortage, and which have not yet been totally abolished, have very gravely penalised the jute industry and still constitute a serious threat to the industry's trading prospects. The evidence for the Chamber's views in this regard will be found in the published results of Companies' and Directors' reports, which show only too often how large a portion of income is taken away in taxation, making it difficult for the companies to maintain a sound financial position or to show satisfactory working results.

Taxation and Economic Development.

Question 18.—What role would you assign to taxation vis-a-vis various types of borrowing in finding the additional resources required for the development programme of the country?

The Chamber considers that the capital requirements of development work can legitimately be met by borrowing, and they are strongly of the opinion that as far as possible resort should be had to this method of finance in order to lighten the crushing burden of taxation.

Question 19.—In maximising the resources required for the financing of development what degree of importance would you assign to:

- (a) prevention of tax avoidance and tax evasion,
- (b) economy and rationalisation in expenditure,
- (c) higher rates of existing taxes,
- (d) fresh taxes,
- (e) development of non-tax revenues?

Of the means of maximising tax revenue which are specified in this question, the Chamber considers that attention should be concentrated on the following three methods, which are given here in the order of importance attached to them by the Chamber—

(a) *Prevention of tax avoidance and tax evasion:*

In the Chamber's opinion, tax evasion on a very large scale has been encouraged and stimulated by the heavy rates of taxation which are now in force and by the multitudinous controls which Government exercise over the affairs of commerce and industry. Whatever may be the merits of any taxation system as such, it is certain that it cannot work to the best effect unless it is enforced rigorously and uniformly. The Chamber has no hesitation in saying that the revenue accruing from existing taxation could be very greatly increased by an energetic enforcement drive. A campaign against tax evasion and black marketeers is, therefore, the most important requisite if the proceeds of taxation are to be increased to a maximum. Finally, and this is perhaps the most important consideration of all, tax evasion on the scale practised during recent years adds to the feeling of frustration by the honest taxpayers, places a premium on dishonesty and encourages a dangerous disrespect for the taxation laws.

(b) *Economy and rationalisation of expenditure:*

The Chamber thinks it is quite impossible to assess the importance of the additional funds which might be produced by economy and rationalisation of expenditure in the various Government Departments concerned. There is ample evidence, however, in the public discussions on State expenditure, particularly those relating to the multi-project dams, etc., to indicate that constant supervision, particularly in these new fields of development, is required if there is not to be waste and extravagance. At the same time, there have been many complaints that financial control is too rigid and highly centralised and ultimately defeats its own objects. It is clear that with the larger Government expenditures envisaged under the development programme, this aspect of financial control must attain increasing importance.

(d) *Fresh taxes:*

The Chamber strongly advocates the imposition of fresh taxes in the sense of extending the field of taxation so as to cover the entire taxable resources of the country and bring within the orbit of contribution that very large section of the population which is at present almost exempt from taxation. As has been recommended earlier, the means of achieving this object is an increased reliance upon indirect as opposed to direct taxation; and the Chamber would suggest here—its proposals are worked out in greater detail in replies to later sections of the questionnaire—that the most efficient, equitable and productive form which indirect taxation can take is a more widespread and uniform sales tax which will apply to all commodities in general consumption.

The other two methods of increasing revenue which are mentioned in this question should not be restored to. Existing taxes already bear very hardly on those who have to pay them and are a serious impediment to capital formation and to the health of the private sector of trade and industry; they should therefore be reduced. As regards non-tax revenues, the Chamber has already submitted that Government projects should not be regarded as a means of raising finance to supplement the public income from taxation.

Question 20.—Under the Five Year Plan the public sector is expected to undertake a larger investment; an important place is also assigned to the private sector in the development programme. How would you devise a tax policy suitable to the development programme of the country in both sectors?

Question 21.—What part can tax policy play in stimulating capital formation in the private sector consistently with the needs of the public sector?

The Chamber's proposals for the financing of developments under the Five Year Plan are, firstly, reduction in the direct taxation of companies and of the investing classes, combined with incentives towards industry, saving and investment; and, secondly, an increased resort to indirect taxation so as to distribute the burden equitably and to tap all legitimate sources of public revenue.

The reduction in direct taxation which the Chamber advocates and the offer of incentives are essential if private saving is to be encouraged and the private sector of the industry enabled to undertake the heavy investment required by it under the Five Year Plan. As a means of promoting investment and the ploughing back of profits into industry, the Chamber would recommend that the Commission should investigate the possibility of making provision for development funds to be constituted by the re-investment of company profits which, on the condition of their being utilised for legitimate and approved development projects, would be exempt from taxation or the subject of substantial tax relief. The Chamber has already commented on the pernicious effects resulting from the levelling down process which is involved in the present system of taxation; it would submit that, as opposed to this steady attrition of the country's investment potentialities, the proposed reduction in direct taxation and grant of incentives to investment would constitute a dynamic taxation policy which would not only re-invigorate trade and

industry and solve many of the country's economic problems—under-development, unemployment, and the absence of indigenous manufactures—but would also in the course of time result in the cumulative production of new wealth and new sources of taxation.

As indicated, the Chamber considers that to collect in future the finance necessary not only for ordinary administrative purposes but for development of the public sector (to the extent that such finance is to be obtained through taxation) increasing emphasis should be placed on indirect taxation with a lowering of the burdens placed at present upon the direct tax-paying classes. The Chamber thinks that this policy is consistent not only with the stimulation of capital formation in the private sector but also provides a satisfactory method for expanding development in the field of public development. The latter to a very great extent meets the needs of, or consists of expenditure which will benefit, the public at large, particularly including those sections on whom the incidence of taxation is at present negligible, and the Chamber considers it equitable that the community as a whole should be more directly involved than it is at present in producing the finance necessary for those projects.

Question 22.—(i) *Is there evidence for the view that the rate of private capital formation in the community has been lower in the last few years as compared to the pre-war period? What factors in your opinion account for the decline?*

There is evidence on every side that industry to-day finds difficulty in raising finance not only for new concerns but for replacing or rehabilitating existing plant and an examination of company accounts will show that industrial operations are now conducted on bank advances to a far greater extent than in pre-war years. The decline in private capital formation and investment is particularly evident from the results of the recent investigation into the working of the first two years of the Five Year Plan, which has shown that the private sector of the economy is falling far short of the investment targets set for it under the Plan. This situation is the result of penal rates of direct taxation which not only leave little resources for capital formation but positively discourage hard work and saving. A system of direct personal taxation which increases steeply as taxable income becomes larger amounts almost to special discrimination against savings, investment and enterprise, for it is the marginal increments of income which are earned by extra effort which form a source of investment; it is precisely on those marginal increments that a graduated direct tax bears most heavily. The entrepreneur or the salaried employee works a little harder so that he may earn a little more, and it is that little more that constitutes a source for saving and investment; under the existing tax system, however, it is this "little more" that attracts the highest rate of taxation; and such a very small proportion of the increment is left to the earner that all incentive to hard work or saving disappears.

(ii) *Has there been a shift in recent years in the sources of capital formation in the private sector as between individuals, corporations and other institutions?*

It is a truism that one result of high taxation is the encouragement of tax evasion and this has been very evident in India during the post-war years. The honest tax-payer has been left with little or nothing to invest and the funds which are available for investment are often money in the hands of the tax evader whose sources are dubious. There has, therefore, been a shift in the sources of capital formation from the honest to the dishonest, and a continuance of the present structure of taxation can only mean that in future the country will have to look to the tax dodger and the blackmarketeer rather than to the honest and responsible citizen for its capital investment. The multiplicity of social welfare schemes and the "security minded" consciousness which they engender has also involved a shift in the sources of capital formation; the small private investor is no longer the backbone of the capital market and the greater part of investment now derives from provident funds, insurance companies and similar institutions whose funds are not available for new risk investment.

Question 23.—*Do you think that tax relief in respect of persons in the middle-income group would assist the growth of savings or mainly promote consumption?*

The Chamber thinks it probable that the grant of tax relief to the middle-income group would result both in increased consumption and increased savings. Increased consumption is not in itself undesirable, for an expanding economy must find its markets and if the country is to industrialise there must be more consumers. There would certainly be larger savings which could probably be increased by skilful and vigorous publicity campaigns and no doubt the experience of Government in conducting the Small Savings movement will be of assistance in this regard.

Question 24.—*The Planning Commission have given an estimate of the rate of progress in regard to*

national income and consumption standards on the assumption of 50 per cent. of the additional output going into investment each year after 1956-57. What measures in the field of taxation are necessary if this assumption is to be realised?

It must be difficult under any circumstances to make an accurate estimate of the kind that has been attempted by the Planning Commission, but the Chamber is inclined to the view that, at the present rate of progress of the Five Year Plan, the Commission's estimate of an investment of 50 per cent. of additional output is decidedly over-optimistic. Certainly the Chamber does not think that such an object will be achieved without the adoption of the tax modifications it has proposed: a reduction of direct taxation, incentives to savings and enterprise, and an extension of indirect taxation.

Question 25.—*Do you accept the view that some regulation of consumption standards is desirable as a means of releasing larger resources for development? If so, what part, in your view, can tax policy play in this process and what should be the relative role of direct and indirect taxes in achieving the purpose?*

The Chamber thinks that the main emphasis towards development should and must come from an overall expansion of production which will allow some of the additional resources to be devoted to capital investment rather than that development should be secured by a diversion of consumption. It is, therefore, strongly opposed to any physical regulation of consumption, the difficulties and disadvantages of which were amply demonstrated during the period of war and post-war controls. It is appreciated, of course, that the greater resort to indirect taxation which they propose may in theory involve some diversion of consumption, but it is considered that the incidence of such taxes taken over the population as a whole would be so low that their effect on individual physical consumption would not be large although the total resources involved might be so.

Question 26.—*How far can tax policy help to promote the efficiency of the productive system? Do you think that multiplicity of taxes in India in respect of the same commodities and their lack of uniformity from State to State affect the allocation of resources in the community and hence the efficiency of the economy? Have you any suggestions for the rationalisation of the country's tax structure in these respects?*

The Chamber considers that a system of taxation modified on the lines it has advocated in reply to earlier questions would assist the efficiency of the production system; certainly it would impede that efficiency to a far less degree than does the present tax structure. The multiplicity of taxes and differences from State to State do, in the Chamber's opinion, hamper the working of the economy and simplification and rationalisation are urgently required. The ideal solution, in the Chamber's view, would be a unified taxation system with all taxes levied by the Centre and with the resultant revenues allocated to the State on an agreed basis. It is appreciated that in a country with a federal constitution such an ideal may be incapable of realisation; but it should at least be borne in mind as the ideal towards which practice should endeavour to approximate.

Question 27.—*How far in your view could the tax system be used to secure any order of priorities in the development programme in the private sector?*

The Chamber does not consider that any general tax system can be effectively used for securing the order of priorities in the development programme of the private sector, but it would invite attention to the proposal for the establishment of development funds made in answer to Question 21 which does furnish a means for stimulating saving and capital formation for approval purposes.

Question 28.—*What are the possibilities and limitations of tax policy as an instrument for economic development?*

- by influencing over-all demand,
- by reducing consumption and unessential investment,
- by positive inducements for desirable investment,
- by redistribution of incomes,
- in other ways?

The Chamber has already stated that, after fulfilling the basic object of raising the State's revenue requirements with the least damage to the economy, the main ancillary function which a taxation system can perform is to promote savings and investment and to encourage enterprise, particularly as envisaged in the suggestion for development funds made in reply to Question 21. Apart from achieving this secondary objective, the Chamber does not consider that taxation should be used for any of the other purposes specified in this question as their efficacy as an instrument for economic development in India is open to grave doubt.

Question 29.—How would you assess the scope and efficacy of tax policy as compared to monetary policy and direct controls as an instrument of planned economic development in India?

The Chamber has no views to offer.

Question 30.—Do you think that the present tax system in India makes for a reduction in inequalities of income and wealth?

Question 31.—What modifications in the tax system would you suggest for securing a larger degree of economic equality, consistently with maintaining the incentives to capital formation and higher production?

The Chamber has noted with some concern that while the second of the Commission's terms of reference is the suitability of the present system of taxation with reference to, first, the development programme of the country and the resources required for it and, secondly, the objective of reducing inequalities of income and wealth, the latter has been placed first in the Questionnaire itself as an objective of a sound tax policy, and there is evidence in later questions, particularly Question 31, that the Commission attach great importance to this particular objective. The manner in which Question 31 has been framed seems to infer acceptance of the belief that adequate incentives to capital formation and higher production already exist and that, whilst maintaining them at their present level, there may still be scope for further progress towards economic equality. The Chamber is in complete disagreement with this general approach and, in particular, with the view that the existing rates still leave sufficient incentive to encourage savings, investment and expanded production. As explained in answers to other questions, it is the considered view of the Chamber that the present levels of taxation involve the serious diminution of the level of incomes in the higher income brackets without any corresponding increase in the social services which might have improved the lot of the poorer sections of the population. In other words, such re-distribution of wealth as has taken place has been of no assistance whatsoever in dealing with the problem of mass poverty. On the other hand, it has seriously prejudiced not only the incentive but the ability to contribute to savings and capital formation and provides no stimulus whatsoever to higher production or efficiency. Any alterations in the tax system to secure a greater degree of economic equality would merely worsen an already unsatisfactory situation.

Question 32.—What place would you assign to public expenditure as compared with the tax system in achieving a greater measure of equality of income?

It is presumed that by income in this question the Commission means real income as expressed in terms of the standard of living and not merely to monetary income. Subject to this, the Chamber's view is that the objects referred to are achieved more satisfactorily by public expenditure devoted to social services than by taxation.

Question 33.—Have you any changes to recommend in tax policy in relation to the investment of foreign capital in India?

Yes, the following—

- The removal of the existing discriminatory super-tax provisions of Clauses (ii) and (iii) of paragraph D of Part II of the First Schedule of the current Finance Act;
- Revision of the definition of "Residence" under section 4A of the Income-Tax Act on the lines indicated in the Chamber's answer to Question 46;
- The negotiation of satisfactory tax treaties with the countries predominantly engaged in foreign trade with India;
- The changes either in the provisions or in the interpretation of sections 42 and 43 of the Income Tax Act indicated in the Chamber's reply to Question 51.

Question 34.—Article 269 of the Constitution enumerates the following taxes which may be levied and collected by the Union but the proceeds of which are to be assigned to the States:

- duties in respect of succession to property other than agricultural land;
- estate duty in respect of property other than agricultural land;
- terminal taxes on goods or passengers carried by railway, sea or air;
- taxes or railway fares and freights;
- taxes other than stamp duties on transactions in stock exchanges and futures markets;
- taxes on the sale or purchase of newspapers and on advertisements published therein.

How do you assess the possibilities of adding to the Country's tax resources in respect of the above items?

In the opinion of the Chamber it may be possible to increase the revenue accruing from succession duties and estate duties in respect of property; the other tax sources mentioned in this question, however, should not be required to make an increased contribution, or any contribution where one is not already levied.

Question 35.—Other possible ways of adding to tax receipts which have been suggested are taxes on capital, reintroduction of the salt duty, surcharges on land revenue, betterment levies, agricultural income-tax, social security taxes and modification of the policy of prohibition having regard to the directive principles of the Constitution. What are your views regarding the desirability and the probable scope of each of these forms of taxation?

The Chamber considers that, in line with its recommendation for an increase in indirect taxation, there is a very strong case for the re-introduction of the Salt Tax in the form of an extension of Sales Tax to that commodity. There is in the Chamber's view an equally strong case for a modification of the policy of prohibition. The large tax revenue surrendered by the States which have introduced prohibition together with the increased expenditure on prevention are more than State budgets can afford, particularly since it appears to be doubtful whether prohibition policy has prevented the abuse of alcohol or indeed its general consumption. It is unlikely that this situation will improve and, as experience in many other countries shows, there may be increasing resort to evasion with the consequent dangers of corruption of the public services and the development of a general contempt for law and order. In these circumstances the Chamber thinks that the policy of prohibition requires drastic modification and indeed that the time for this is already overdue. As regards the reference to taxes on capital or a capital levy the Chamber cannot emphasise too strongly that such a tax would be fatal to the country's future economic development.

Question 36.—Do you consider it desirable and feasible to levy a tax on unearned increments in value of land and other property as a result of public projects of development?

Although the theoretical attractiveness of taxation of unearned increments of land and property value has made it the subject of endless fiscal schemes during the past century in many countries, experience—particularly recent experience in the United Kingdom—has shown, it is thought conclusively, that its application is subject to the most extreme practical and administrative difficulties. It is considered that such a tax in the form in which it has been applied in other countries is impracticable and that the nearest approach which can be made to the taxation of unearned increments is the periodical reassessment of land revenues in the agricultural areas.

Question 37.—What measures would you suggest for increasing the receipts from existing sources of revenue?

In this connection the Chamber thinks that a vital aspect of any attempt to diminish tax evasion is to stir up public opinion against it and in support of the honest taxpayer who meets his obligations. It is suggested, for consideration, that Government might be prepared to publish lists of those who have fulfilled their obligations in this respect; this is already done, it is understood, in Sweden and the United States. A possible alternative is to give active support to the formation of an organisation of taxpayers which would give suitable publicity and honourable mention to those who have paid their taxes and which, in particular, would encourage the spirit of emulation in the declaration of the highest published incomes and income-tax payments.

Question 38.—What other new sources of taxation can you recommend?

Apart from the Chamber's main proposal for an increase in indirect taxation, particularly by an extension of sales tax, the only other new source of taxation which it desires to recommend is a State lottery. The particular advantages of State lotteries are their ease of collection and their psychological effect in introducing an element of hope into the daily grind where poverty is all too common. The Chamber would suggest that the Commission should give its most careful consideration to this proposal; and since such objections as there are likely to be to a State lottery will probably be based on ethical considerations, the Chamber would further suggest that the proceeds of the lottery might be allotted for some specifically desirable object such as education or an extension in hospital and medical facilities. In addition, the Chamber would point out that this method of raising revenue has been adopted in many countries.

Question 39.—To what extent and as regards what taxes should the powers of the Centre to impose surcharges under Article 71 of the Constitution be used?

The Chamber has no views to offer on this question.

Taxation and Inflationary and Deflationary Situation.
Question 40.—What are the scope and limitations of tax policy as an instrument for dealing with inflationary or deflationary situations in Indian conditions?

Question 41.—*In countering inflationary or deflationary conditions in the economy, what part would you assign to changes in the following :*

- (a) direct taxes,
- (b) indirect taxes,
 - (i) import duties,
 - (ii) export duties,
 - (iii) excise duties,
 - (iv) sales tax?

Question 42.—*To what extent is it possible to increase the inherent capacity of the tax system to counter-act inflationary or deflationary conditions in the economy?*

Question 43.—*What are your views in regard to the relative importance of public expenditure policies in moderating the forces of inflation and deflation in Indian conditions?*

Question 44.—*Apart from using tax policy to counter inflation or deflation in the economy as a whole, would you suggest tax changes for dealing with the effects of rising or falling prices on particular groups of taxpayers or sectors of the economy?*

Question 45.—*How do you assess the present situation in regard to the strength of inflationary or deflationary influences, and what adjustments, if any, in taxation are indicated in the light of your views?*

Answer to questions 40 to 45—

Taxation policy has a useful, but not decisive, role to play in meeting inflationary and deflationary situations. Under Indian conditions, however, there are so many practical difficulties in the application of modern British and American theories on this subject, and so many uncertainties as to their effects, that the Chamber regards this section of the questionnaire as of academic, and secondary, importance. Accordingly it is confining itself to a single comprehensive statement.

To take deflationary situations first. The correct tax policy at such times is to lighten the tax burden, particularly personal and company taxation. Rates of taxation under these latter heads are now so high in India that if an acute deflation were encountered in the next few years as a consequence of a world trade slump, there would be ample scope for sharp and beneficial reductions as part of a "contra-cyclical" tax policy.

Turning to the more familiar danger of inflation, the Chamber contends that the Government has quite sacrificed the flexibility of this weapon by perpetuating as normal the very high rates of taxation introduced as an anti-inflationary measure during the war. The great increases in personal and corporate taxation in the years 1940-47 made a contribution (though a limited one) to the control of inflation; but their retention as part of the tax structure has meant surrender of the usefulness of tax policy as an antidote to inflation. Not only would further increases in personal and corporate taxation be a source of positive inflationary forces, but current rates tend to perpetuate inflation by discouraging extra productive effort. Taxation that aims at draining off surplus money is apt to defeat its own objects, for by diminishing the reward for hard work and special exertion it causes a decline in productivity. The result is that, in a situation where there is too much money chasing too few goods, this supposedly disinflationary taxation reduces the goods as well as the money and thus fails to achieve its object. This is aggravated by the encouragement which high rates of taxation give to company managements to indulge in irresponsible expenditure and to the private citizen to divest himself of taxable income. Therefore the first requirement of any policy that aims at using personal and corporate taxation as an anti-inflationary measure is that rates of taxation be brought down from the ceiling. Similarly, to realise the utility of brakes on a motor-car it is necessary that they should not be applied all the time.

Even when these adjustments had been made, there would still be features of the Indian tax system that make it less effective for the purpose of controlling inflation. The chief of these features has been referred to above—the incidence of taxation on a small section of the population, which leaves the bulk of inflationary purchasing power outside the scope of disinflationary tax policies. Under the tax system that has hitherto been in force, the greater part of the population has been practically exempt from taxation. It is their needs however, and particularly their need of the elementary necessities like food, clothing and housing, which give rise to the main economic stresses; taxation does not touch these needs at present and is therefore largely ineffective during an inflationary crisis. The revision of the tax system that the Chamber suggests, by extending the scope of taxation over larger sections of the population, would considerably increase the effectiveness of tax policy both in inflationary and deflationary situations. Such price rises as would be caused by an increase in indirect taxation would not be inflationary because they would be "once-for-all" rises, unlike the cumulative price rises that occur in an inflationary spiral. The increment in price caused by higher indirect

taxation would be drained off by Government, and since it could not then be reflected in a rise in business profits would not be able to cause further rises in other prices. The snowballing effect of rising prices, rising profits and more price rises, which is precisely the feature of a genuine inflation, would be avoided in the case of price rises brought about by disinflationary taxation on articles of common consumption. Conversely, the revision of the tax system suggested by the Chamber would enhance the value of tax policy as a weapon against deflation. Reductions in indirect taxation would stimulate purchasing by bringing about lower prices without the appearance of business losses which provide the cumulative factor in a slump.

Finally the Chamber would warn against the too facile application of disinflationary taxation theories framed in other countries to the vastly dissimilar conditions of India. In the countries where these theories originated, taxes bear on most incomes; in India they bear on only a small minority of incomes. When pressed too far, therefore, the inflationary consequences of high taxation appear more quickly in this country than in countries like Britain which realise only slowly (but none-the-less surely) the limitations of "contra-cyclical" taxation.

PART II—"DIRECT TAXES"

RESIDENCE.

Question 46.—*Do the provisions of the Income-tax Act (Sections 4A and 4B) regarding the determination of residence of various assesses, viz., individual, Hindu undivided family, firm, association of persons and company, require any modification? In particular, what is your view regarding the retention of the category described as "not ordinarily resident"?*

Yes; the present basis of determining "residence" on the part of a company by reference to income is fallacious and acts as a deterrent to the flow of capital into the country which it is the policy of the Government of India to encourage within limits and subject to reasonable conditions. There is no justification, in the Chamber's opinion, for assessing income that arises outside India. This important and deterrent provision of the law is due to the present artificial definition of "residence" under Section 4A(c) which, in contradistinction to the treatment for instance of a Hindu undivided family, applies two criteria, namely (a) if the control and management of the affairs of the company are situated wholly in the taxable territories of India or (b) if the income of the company arising in the taxable territories exceeds the income arising without the taxable territories. Criterion (b) should, in the Chamber's view, be deleted not only because of the effects of it referred to above, but because its artificial nature has an adverse influence on the negotiation by India of satisfactory tax treaties or Double Income Tax Avoidance Agreements which would in themselves remove many of the present impediments created by the artificial definition of "residence".

The category "not ordinarily resident" should certainly be retained. It equitably caters for numerous cases in which expert technical and other advisers can visit India for relatively short visits; without this category of "not ordinarily resident" India might well be deprived of the temporary services of such technicians and consultants to her own disadvantage and to the detriment of the Five Year Plan.

A related question arises in connection with Section 4A calling for an amendment of the latter section. For the purpose of that section the "income arising in taxable territories" is one of the alternative criteria for the determination of "residence" and there is nothing positive to show that agricultural income is not included in income for that purpose. In the Chamber's view this should be remedied by the addition of an explanation or proviso to Section 4A making it clear that "income" for the purposes of that section is income taxable under the Indian Income-Tax Act.

INCOME.

Question 47.—*Does the definition of "income" [Section 2(6C)] require any modification?*

The reference to "capital gains" could now suitably be deleted from Section 2(6C).

Question 48.—*Are there any receipts or gains which are not taxed at present but which, in your opinion, should be taxed and vice versa? In particular, what is your view regarding the taxing of capital gains?*

In the Chamber's memorandum to the Commission, dated the 30th May, 1953, reference was made to the tendency of certain Income-Tax Officers, whether of their own volition or under directions from the Central Board of Revenue, to disallow (in disregard of the assessee's contentions) what the latter claims to be perfectly legitimate expenses incurred for the purposes of the business; and secondly, to compel the assessee to resort to appeal, thus involving the latter in legal

expenses which are in turn disallowed—as also, quite unjustifiably, are items such as costs of renewals of leases and patent and copyright expenses. There is also a tendency on the part of Income-Tax Officers, outside their own functions as revenue officials, to query the powers of a company in such matters as the quantum of directors' remuneration where the profits are small; of bonus or other payments to employees either awarded by Tribunals or which appear to the I. T. Os. to be high in relation to a low basic salary scale or are due to the recognition of personal initiative; and of other items of business expense which the I. T. O. personally considers to be out of proportion to the size of the business. Where there is clear evidence of *bona fide* expenditure other than capital expenditure having been incurred for the purposes of the business, such expenditure should be allowed without question.

Under an Act designed to tax income, capital gains should not be taxed. And if they are taxed under any separate enactment—for which there would seem to be no justification with the pending introduction of estate duties—provision should clearly be made for the allowance of capital losses.

Question 49.—*Have you any comments on the present position regarding taxation of profits, which accrue or arise abroad, on their repatriation to India?*

The Chamber considers that, where the tax payer is prevented from transferring the income to India either by the laws of the overseas territory or any executive action of its Government or by the impossibility of obtaining foreign currency in the territory, the assessment of tax on income arising abroad should be deferred. In addition, where exchange control regulations are responsible for delay in the repatriation of such profits beyond the dates specified in Section 4, the Income-Tax Officer should be specifically required to deem such profits eligible for the advantages they are intended to enjoy.

Question 50.—*What change, if any, is called for in the definition of "dividend" [section 2(6A)], e.g., in relation to "bonus shares"?*

Clause (d) of sub-section (6A) of Section 2 includes within the definition of "dividend" "any distribution made to the shareholders of a company out of accumulated profits on the liquidation of the company" subject to the proviso that only the accumulated profits so distributed which arose during the six years preceding the liquidation shall be so included. The Chamber considers that this provision of the Act should be so worded as to make it clear that the shareholder on liquidation shall be taxable only to the extent to which the distribution exceeds the capital value of the shares, i.e., the nominal value whether received for cash or for value and that only to that extent bonus shares issued within the six-year period shall be taxable.

Question 51.—*Do the provisions of the Income-tax Act relating to the taxability of non-residents through their business connections in India in respect of income deemed to accrue or arise within the taxable territories (section 42 and 43 of the Income-tax Act) affect adversely the interests of persons engaged in foreign trade? If so, what modification would you suggest in these sections?*

Yes, the interpretation now being placed on these sections very materially affects the interests of persons trading with but not in India and is becoming a strong impediment to the development of that trade in the absence of tax treaty arrangements or D. I. T. Avoidance Agreements with other countries, particularly the U. K. For instance, Income-Tax Officers here are seeking to raise assessments on concerns in India as Agents for non-residents where the concerns in question are buying goods in India on behalf of non-residents. Again, non-residents manufacturing goods outside India, selling them outside India to residents in India and then shipping the goods to India and forwarding documents to a Bank in India for the Bank to collect the sale proceeds on behalf of the non-residents and deliver the documents to the buyer when payment has been received are faced with the contention that this constitutes receipt of the proceeds which includes the profit in India by or on behalf of the non-residents and that therefore the whole profit is assessable in India.

There is a considerable amount of case law on this question to which the Chamber would invite the Commission's attention, such as Civil Appeal No. 41 of 1952, *Messrs. Turner Morrison & Co., Ltd. vs. Commissioner of Income-Tax, West Bengal*. These cases, and the earlier ones referred to therein, exemplify the range of commodities forming an important part of India's international trade which stands to be affected most adversely by the current interpretation of Sections 42 and 43—Tea, Wool, Salt, Shellac, to mention a few. With regard to the mere purchase of goods in India and other acts which have been held to constitute operations carried out in India for profit by or on behalf of a non-resident, a charge of tax under Section 42 is a most serious deterrent to trading with India. Other countries do not admit the validity of India's claim to tax and refuse double

tax relief for Indian tax suffered. At the present time this means that any profit attributed to the act of purchase suffers an overall tax burden of more than 100 per cent. where the non-resident buyer is resident, for example, in the United Kingdom, United States, Germany or Japan. There can be no arguing that a consequence of this kind will affect trade with India to an increasing extent as Section 42 is more and more diligently applied and it should not be forgotten that in recent years India has relied upon buyers in these territories to take more than 50 per cent. of her exports. The result of allowing this position to continue will inevitably be a grave restriction of trade to India's detriment in a buyers' market; overseas sellers will either refrain from trading with India or will do so only where the title in the goods and payment can be obtained outside India. It is very essential therefore that prompt steps should be taken (a) to amend the law to exempt, in the case of the non-resident who buys or sells goods in India, the manufacturing and other profits attributable to operations carried on outside India by the non-resident and (b) to exempt profits when the non-resident has not an established place of business in India.

Several of the difficulties referred to above arise because of the absence of any statutory definition of "business connection" thus permitting a variety of interpretations by individual Income-Tax Officers. This omission should be remedied, it is suggested, in such a way as to ensure that non-residents may be more precisely aware of their liabilities under the Act. Based on current international practice as agreed to by most countries in recent double income-tax agreements—the negotiation of which, particularly with the United Kingdom as India's largest customer, is very essential—an explanation should be added to Section 42 providing firstly that a non-resident person shall not be deemed to have a business connection in the taxable territories unless he maintains therein a branch, management, factory or other fixed place of business; secondly, that an agent in the taxable territories for a non-resident person shall not be deemed to be a business connection unless he has and habitually exercises a general authority to negotiate and conclude contracts on behalf of the non-resident or keeps a stock of merchandise from which he regularly fills orders on his behalf; thirdly, that a non-resident person shall not be deemed to have a business connection in the taxable territories merely because he conducts business dealings through a *bona fide* broker or general commission agent acting in the ordinary course of his business as such; and, fourthly, that a fixed place of business or an agency maintained by a non-resident person solely for the purchase of goods within, and the sale or conversion of these goods without, the taxable territories shall not be deemed to be a business connection.

Question 52.—*What modification would you suggest in the definition of "agricultural income" [section 2(1)] to avoid the contingency of the same income being taxed by the Central Government as well as the State Governments, e.g., in respect of income from forests, dividends from agricultural companies, etc.?*

As was pointed out in the Chamber's memorandum to the Commission, dated the 30th May 1953, this involves the constitutional question, which is recognised to be a difficult one, of the respective rights of the States and the Central Government. The Chamber then urged, and still urges, that whatever these difficulties, the essential from the assessee's point of view is that there should be a co-ordinating authority which will determine the assessee's taxable income from whatever source, that the agricultural income should then be arrived at and that the agricultural portion so determined should then be taxed either by the Centre on behalf of the States or by the latter on a uniform basis. The definition should be amended to make it clear that any dividend or part thereof paid out of agricultural income should also be treated as agricultural income. The definition of "agricultural income" should be amended in such manner that the agricultural income arising in a foreign country is treated as "agricultural income". This will avoid the same income being taxed under Agricultural Income-Tax in the foreign country and under Indian Income-Tax in India.

Question 53.—*Are you in favour of integrating agricultural income with non-agricultural income for rate purposes? If so which of the following methods would you advocate:*

- (i) Aggregation of agricultural and non-agricultural incomes only under the State Acts;
- (ii) Aggregation of agricultural and non-agricultural incomes only under the Central Act;
- (iii) Aggregation of agricultural and non-agricultural incomes both under the State and the Central Acts?

Please discuss the administrative, constitutional and other problems that are likely to arise if any of the above alternatives is adopted.

No; the Chamber is not in favour of integrating agricultural income with non-agricultural income for rate purposes.

Question 54.—Would you recommend the abolition, by a suitable amendment of the Constitution, of the distinction between agricultural and non-agricultural incomes and the taxation of both types of income, aggregately under a Central Act?

No. As has already been suggested in the Chamber's answer to Question 52, the essential is that the assessee's taxable income from whatever source and the agricultural portion thereof should be determined by a single authority and the State Agricultural Income-Tax Acts made uniform in this respect.

Question 55.—Is the treatment given to irregular and fluctuating income in the present law satisfactory? In particular, should any changes be introduced—

- (i) to average income over a number of years where receipts are irregular and fluctuating;
- (ii) to spread lump sum receipts over a number of years?

The existing provisions of Section 12AA, introduced by the Finance Act, 1953, represents an improvement on the previous position.

EXEMPTIONS.

Question 56.—Do you think the present provisions regarding exemption of charitable and religious trusts need any modification? If so, in what respects?

On the assumption that this question relates only to the taxation of the income of charitable and religious trusts, as distinct from the allowance of donations to such bodies, the Chamber has no suggestions to make at present. So far as donations to charitable and religious trusts are concerned, further time is required to observe the practical effects of the recent amendments made to Section 4(3)(i).

Question 57.—(i) Should the business profits of co-operative enterprises, which are now exempt, be charged to income-tax and super-tax? If so, should co-operative societies be treated as companies or should a lighter levy be imposed? In case the exemption is continued, should it be restricted to certain categories of co-operative enterprises.

(ii) Do you agree with the view that the income derived by co-operative housing societies by way of rent should not be treated as income from property assessable to income-tax? Would you, in this respect, differentiate between tenant co-partnership housing societies and other types of housing societies?

(iii) It has been suggested that there are divergent decisions by different Income-tax authorities in respect of assessment of income of co-operative societies from sources other than business. If this is so, please indicate such decisions and the measures you would suggest to secure uniformity in assessment.

In the view of the Chamber the position of co-operative societies, Chambers of Commerce, clubs and the like should remain as at present to the extent to which their activities are mutual.

Question 58.—Are you in favour of continuing the concessions given to new industrial undertakings under section 15C of the Income-tax Act? Have initial and extra depreciation allowances made the concessions practically infructuous? If so, what are the directions in which the provisions of this section should be modified?

Section 15C was introduced with the intention of granting relief to newly established industrial undertakings but has not in practice been of much benefit to them, principally owing to the initial and double depreciation allowances which merely have the effect of a postponement of tax and do not reduce the ultimate liability.

It seems to the Chamber therefore that consideration should be given to some means whereby more substantial benefit will accrue under Section 15C. One such method, which the Chamber recommends, is that a newly established company should have the option of taking an allowance under Section 15C in preference to the initial and/or double depreciation allowances; the 15C allowances would then be an exemption from liability to tax on a portion of the income of the company and not merely a postponement of the payment, while the depreciation allowances would be obtainable at some future date.

Question 59.—A suggestion has been made that banking profits of foreign branches of Indian banks should be given concessional treatment for tax purposes in order to encourage the opening of branches abroad. What are your views?

The Chamber sees no sound grounds for such an arrangement.

Question 60.—Should any liberalisation be made in the present limits of exemption from tax of life insurance premia and contributions to provident funds?

Yes—certainly. It is, in the Chamber's view, quite unrealistic that the 1939 limits should continue under

present day conditions (a) when the costs of living are so much higher with no prospect of their returning to pre-war levels in the foreseeable future as Government themselves admit, (b) when the policy of Government and private employers alike is to provide more for saving by introducing and liberalising provident funds for their employees, whether in accordance with legislation, tribunal awards or by invitation. In recognised Provident Funds both employers' and employees' contributions should be deducted from total earned income to arrive at the taxable earned income both for income-tax and for super-tax purposes. In addition, the present limit of Rs. 6,000 in respect of exemption from tax on life insurance premia and provident fund contributions should be raised to Rs. 12,000 or one-sixth of income whichever is the lower.

ALLOWANCES.

Question 61.—(i) Do you favour the grant of larger depreciation allowances to assist industry to finance the considerably increased costs of replacement of assets? If so, how and in what form should they be given—

- (a) by larger depreciation allowances on new assets;
- (b) by revalorisation of existing assets;
- (c) by treating the excess of replacement cost over original cost as revenue expenditure;
- (d) by any other method?

(ii) What is the justification for assistance from public resources to certain classes of tax-payers only by way of covering partially the excess of replacement cost over original cost of old assets?

(iii) In case adequate justification exists for assistance by Government in the form of tax concessions to meet the situation, what safeguards should be prescribed to see that the funds so made available are utilised for the purposes for which they are intended?

(i) Under present conditions of rising prices and high taxation it is difficult, if not impossible, for established companies to set aside out of taxed profits sums sufficient to replace their buildings and plant. This is a matter of particular concern in view of the continuing rise in prices which has not only persisted for several years but shows no sign of abating.

Initial depreciation allowances are at best a compromise since they merely represent a postponement of liability to tax, but in so far as they have been of limited assistance to companies which have been able to replace plant and machinery they should be retained in the taxation structure.

The crux of the problem is not so much to devise a new method of computing depreciation on new assets, since these will be brought in at cost which will equate with replacement value, but to evolve a means of granting larger allowances on existing assets so that funds may be accumulated for their eventual replacement. It is suggested that, in spite of the administrative difficulties involved which will inevitably arise from any departure from the present system of granting depreciation allowances, this may best be achieved by the revalorisation of existing assets for income-tax purposes, taking 1939 as the base year.

An alternative, simpler and perhaps preferable method would be to allow an assessee to charge in addition to his aggregate normal, double and initial depreciation a further sum on the understanding that (a) this further sum is placed to a special Reserve, (b) the Reserve will be applied only for the purchase of new block items, (c) the original cost of any new block items will be reduced by the tax on so much of the Reserve as is utilised for their purchase, and (d) any part of the Reserve not utilised will be added back for tax purposes.

A connected question arises. In the event of loss of buildings or plant, insurance payments are treated as a taxable profit under Section 10(2)(vii) to the extent to which if the asset is insured for its replacement value, such insurance payments do not exceed the difference between the written down value and the original cost. In the Chamber's opinion Section 10(2)(vii) should not be applied in such circumstances provided the asset is in fact replaced and subject to the proviso that the tax foregone will be deducted from the original cost of the replacement for tax purposes.

(ii) The justification surely is that unless some such step is taken, industries in this country will not be able to modernise and expand as they cannot at present find the difference between the replacement cost and the original cost out of taxed income; and in existing competitive world markets, India's products will quickly be outpriced with a consequent contraction of business and assessable profits to the detriment of the country's revenues.

(iii) It will be necessary to provide that the depreciation allowed in the form of such concessions must be funded and utilised for the purpose for which it is put to reserve within a reasonable period.

Question 62.—*Are any changes called for in the classification of assets for purposes of depreciation, rates of depreciation and methods of computing the allowances?*

The Chamber considers that the existing classification of assets and the rates applicable to them are reasonable. A change, however, is very necessary in the method of computing the allowances. The amount of time and money spent by assesseees and their advisers in computing depreciation based on the month when the building is completed or the machinery is installed is colossal. These involved calculations serve no real purpose and little revenue would be lost by reverting to the previous practice of calculating depreciation on the additions for any particular year on the basis of the whole year.

Allowances should also be granted for such items as development expenses, exploration for oil, if not dealt with by way of depletion allowances, and for patent and copyright expenses and other items of a similar nature.

Question 63.—*Should any tax concessions be given to encourage development of mineral resources? If so, what form should they take? In particular, should depletion allowance on wasting assets be allowed? How should it be computed for different kind of assets you have in view?*

In the opinion of the Chamber it is most important that tax concessions should be given to encourage the development of the mineral resources of the country. The special justification for this is the extent to which the exploitation of minerals involves not only operations of a costly and uncertain nature but also involves wasting assets. In other countries income tax laws make due recognition for these special characteristics. For instance, in Canada a percentage depletion allowance of 33½ per cent. of nett profits may be claimed by mines producing base metals and industrial minerals from "non-bedded deposits". In the United States metal mines are allowed 15 per cent. depletion allowance on gross income limited to 50 per cent. of the nett income after charging depreciation, rent and royalties but before charging depletion itself. It is essential, in the Chamber's opinion, that percentage cost depletion allowances as well as provision for the treatment as revenue of certain expenditure which has been considered capital expenditure in the past, should be introduced for companies working wasting assets. It should be made possible in such cases for the company to obtain more than 100 per cent. of the original cost.

Question 64.—*In what form would you provide for personal and family allowances—*

- (i) *exempting the first slice of income from tax; or*
- (ii) *providing specific allowances for family and dependents?*

In the case of (i), do you consider that the first slice—Rs. 1-1,500—should be revised? In the case of (ii), what treatment would you give to the Hindu undivided family?

The view of the Chamber is that personal and family allowances could not work satisfactorily under existing conditions in India.

Question 65.—*Should the present law regarding admissible expenses [section 10(2) be altered]? If so, please indicate, with reasons, the items of expenses (i) which are not now admissible but, in your view, should be admissible and (ii) which are now admissible but, in your view, should not be admissible.*

Yes; and, as already pointed out in answer to Question 48, Income-Tax Officers should be directed to adopt a more reasonable and less grudging attitude towards expenses as a whole incurred for the purposes of the business.

The following are among the items now either inadmissible which ought to be admissible or which are frequently allowed only in part or after appeal:

- (a) Bonuses or other payments made by the employer to employees.
- (b) Legal expenses including those of appeal under the Act and otherwise should be allowed but not those on the acquisition of capital assets.
- (c) Costs of renewal of leases.
- (d) Patent and copyright expenses.
- (e) Directors' remuneration as agreed by the company irrespective of the profits of the company.
- (f) Other *bona fide* items of expenditure referred to in answer to Question 48.

All these are legitimate expenses incurred for the purposes of the business and should not be called in question.

The Chamber is not aware of any allowances now admissible which should not be admissible in the future. On the other hand the Chamber is strongly of the

opinion that, from the point of view of the country as a whole, it is desirable that the disallowance of interest on borrowed capital which is payable outside the taxable territories should be abandoned.

RATE STRUCTURE.

Question 66.—*(a) Are you in favour of combining income-tax and super-tax into a consolidated levy?*

- (b) *What are the merits or demerits of such a step from the point of view of (i) assesseees, (ii) administration?*
- (c) *Are you satisfied with the degree of progression in the present rate structure (both income-tax and super-tax) especially in regard to its economic effects?*
- (d) *In case you consider a change is necessary, what alternative rate structure would you recommend?*
- (e) *Should the rate of surcharge levied under Article 271 of the Constitution also be graduated?*

(a) Yes, but for companies only. While any adjustment of rates would present points of difficulty, the grossing and credit for tax on dividends from limited companies in the case of individuals might be limited to a proportion of the consolidated rate of tax applicable to companies.

(b) The principal merit from the point of view of assesseees who are companies is that it would more readily enable them to ascertain their liabilities, but on balance it would make little difference. From the administrative angle, a consolidated levy is simpler. Conversely, consolidation would necessitate some change in the amount or percentage of the Centre's income-tax receipts allocated to the States.

(c) No. In the Chamber's Memorandum of the 30th May strong emphasis was laid on the fundamental need for a revised tax system which would offer greater incentive to the individual to work harder in order to save and invest and attention was invited to the potentialities of three main categories of individuals whose position in this respect called for consideration, viz. (i) the large group of persons mainly of the employed and salaried classes who, under a more encouraging tax structure, would habitually set aside money for saving and investment, (ii) self-employed persons, particularly among the professional classes and (iii) technicians.

By reason of the unduly steep progression of the super-tax rates, especially in the lower and middle slabs, saving for investment on the part of these classes particularly is well-nigh impossible under present-day costs of living. Initiative and hard work are therefore at a discount and capital formation, whether in the private or the public sector, is correspondingly difficult and prejudiced.

(d) The super-tax progression should be much more gradual in the slabs indicated above. The steps in the present structure are too high and might be replaced by a suitable percentage structure which would give a greater range of variation and scope for a more gradual progression.

(e) No, for the reason that any increase in the rate of surcharge for any category of assessee might mean a total tax in their case out of ratio with others. In particular, an increasing percentage might mean a total rate in the case of those with the larger incomes of such an amount that there would be a loss of incentive and a lack of funds for saving and investment.

Question 67.—*Have you any change to suggest in the exemption limit for individuals (Rs. 4,200) and for Hindu undivided families (Rs. 8,400)?*

The greater need, from the point of view of the country's economic progress and industrial development, is not so much for an increase in the exemption limit as for the grant of increased allowances such as those on earned income and provident fund/life assurances which will lead to increased saving, investment and capital formation.

DIFFERENTIATION.

Question 68.—*(a) Are you in favour of a distinction being made between earned and unearned incomes? What is the economic justification for such a distinction?*

(b) *Is the present definition "earned income" in section 2(6AA) of the Income-Tax Act adequate in this respect or would you suggest any modification?*

(c) *Should the quantum of relief now afforded be extended or reduced? If so, to what extent?*

(a) Yes, this distinction should be continued and if possible made more attractive to wage and salary earners, including pensioners. It is one of the main stimulants to productive effort of which the country stands in great need if the current Five Year Plan and its successors are to be successful.

(b) In the Chamber's view the present definition is satisfactory.

(c) Yes. It would go a long way towards achieving the purpose referred to above were the quantum of relief increased from Rs. 4,000 to at least Rs. 6,000 or one-fifth of income whichever is the lower.

MISCELLANEOUS.

Question 69.—Have you any changes to suggest regarding the principles followed in valuing stocks of a business for assessment purposes?

Yes. The methods adopted by individual income-tax officers have not been consistent in the past, for instance in the acceptance of market rates. In the Chamber's view, the basis should in future be either cost or market rate whichever is the lower in the case of manufactured goods. But in the case of seasonal crops, such as Tea, which are ordinarily sold between the close of the financial year and the preparation of the accounts, the existing system of allowing these "stocks" to be valued at the actual prices realised should of course be continued.

Further, in the case of raw materials there is no need to write down to the replacement cost if the raw materials in question can be manufactured into the finished article at their existing price and still be sold at a profit. But the valuation should also be at cost or market price whichever is the lower, the market price in this case being the sum at which the finished product can be sold less the cost of manufacture.

Question 70.—Do you consider that any change is called for in the method of assessment of the Hindu undivided family? If so, in what respects?

The Chamber is not competent to express an opinion.

Question 71.—Should exemption from income-tax be allowed in respect of voluntary surrender by managing agents of the whole or a part of managing agency commission? What safeguards should be laid down against misuse of such a provision?

Yes, in all fairness, where commission is foregone in the interests of the managed company. The practice of attempting to tax foregone managing agency commission is a very recent development and the inequity of it, in bona fide cases even where the commission has been drawn and subsequently refunded when the results of the managed company are ascertained, has been represented in detail to the Central Board of Revenue.

It is of course necessary for the I. T. O. to satisfy himself that the foregoing or refunding of the commission is irrevocable and not a deferment—as can readily be done in individual cases and surely requires no check in the case of managed public companies.

Question 72.—On what basis would you suggest that double income-tax avoidance agreements should be concluded between India and other countries?

On the model of what is now widely accepted as the standard form of international tax treaties or D. I. T. Avoidance Agreements such as those between the United Kingdom and the United States, between the United Kingdom and Canada and between the United Kingdom and Burma; that is to say, on the principles (i) that each country taxes only such portion of the income as originates in that country through a regular establishment, (ii) that the profits of shipping and aviation companies are exempt and (iii) that the same income is never doubly taxed.

Unilateral relief is now obtainable in the United Kingdom up to a maximum of 100 per cent. of the United Kingdom rate on profits outside the United Kingdom and on this particular income so long as the rate in India is lower than the rate in the United Kingdom, the individual tax payer does not suffer. The rate in respect of branches of United Kingdom companies has, however, been increased by 6 pies to 8-45 annas in the rupee under the recent Budget; and in view of the recent reduction of taxation in the United Kingdom and the possibility of further reductions in future, care, it is suggested, should be taken to ensure that the rate in India is not higher than that in the United Kingdom.

While on certain income, so long as the Indian rate of tax is below that in the United Kingdom full recovery will be made under the unilateral relief provisions in the United Kingdom law, it should be borne in mind that unilateral relief is limited to income accruing or arising outside the United Kingdom while relief in India is limited under Section 49D to income accruing outside India. There is, however, no relief in either country in respect of income accruing or arising in the United Kingdom but deemed by India to arise or accrue in India. This is a matter which should receive the Commissions consideration.

Question 73.—Is the present law relating to determination of "bona fide annual value" of property and deductions allowed from it satisfactory? If not, please give any alternative proposals you have in this respect.

The law relating to the determination of "bona fide annual value" is not unsatisfactory, except that the owner's share of Municipal Taxes should be deducted, but the deductions allowed from it are totally inadequate. The allowance for repairs should be the actual or the average of the past five years and the deductions permissible for collection charges and the like should be the actuals as for the computation of profits for the purposes of the business.

Alternatively, where the property is let out, the whole of the income from property should be calculated on the actuals with an allowance for depreciation on the property as in the case of buildings used for business.

Question 74.—Is any change required in respect of provisions relating to carry-forward of losses? Are you in favour of allowing losses to be carried backward in case of cessation of business?

Under the law as recently amended, the provisions relating to the carry-forward of losses are satisfactory. It should, however, be possible to carry forward a loss under one head and set it off against any normal income in future years, other than gambling income. It should also be permissible for losses to be carried backward in the case of cessation of the business.

Question 75.—Do the provisions relating to the payment of advance tax under section 18A of the Income-tax Act need any modification?

Yes. Section 18A assessments should be abolished as the circumstances justifying that provision have now disappeared. The money involved is almost invariably urgently required for the purposes of the business and if not immediately required would be temporarily invested. The advance payments place a heavy burden on industry to no purpose other than a temporary increase in the Government's cash position. Payment of tax on profits before they have been ascertained is indefensible under existing conditions of monetary stringency and the difficulty involved in framing advance estimates of tax is considerable.

Question 76.—Do the principles underlying the assessment under section 34 of the Income-tax Act need any modification?

The Chamber would not go so far as to urge the removal of the powers under Section 34 relating to income escaping assessment but deprecates the abuse of them which sometimes occurs, such as their use by an Income-Tax Officer to re-open an assessment made by his predecessor and accepted in good faith by the assessee merely because the Officer considers that his predecessor has handled the case incorrectly. This leads to a disturbing lack of finality which is unfair to the assessee. The section should not be used to remedy omissions or lack of knowledge on the part of an Assessing Officer.

Question 77.—What measures would you suggest for simplifying the procedure of assessment in order to reduce the cost of compliance with tax regulations?

The following:

- Abolition of the system of computing depreciation allowances based on the months in which the building is completed or the machinery installed (see answer to Question 62);
- Instructions to I. T. Os. to refrain (i) from the practices referred to in the Chamber's answer to Question 48, e.g., disallowance of legitimate revenue expenditure for the purposes of the business, (ii) from placing on the assessee the burden of supplying answers to irrelevant questions having no direct bearing on the assessment and (iii) repeating questions, however, relevant, which have already been answered;
- The training of a cadre of Income-Tax Officers imbued more with the spirit of service to the public and less with the idea that all assesses are tax-dodgers.

Question 78.—It has been suggested that the Appellate Tribunal should have powers to enhance assessments in the same manner as Appellate Assistant Commissioners have. What is your opinion?

The Chamber sees no justification for this suggestion. The powers of the Department under the law as it at present stands are adequate.

TAXATION OF COMPANIES AND SHAREHOLDERS.

Question 79.—Do you recommend that an element of progression should be introduced in the corporation tax?

No. The effect would be to encourage the subdivision of a growing and thriving company into two or more separate companies.

Question 80.—Would you advocate different rates for different types of corporate enterprises, e.g.—

- small industries;
- cottage industries;
- private limited companies or what may be termed proprietary companies;
- holding companies?

No.

Question 81.—There is a demand for the exemption of inter-corporate dividends from corporation tax. Do you consider this justified and, if so, why?

Yes. As was pointed out in the Chamber's previous memorandum, a large proportion of business has been

expanded in other parts of the world by means of subsidiaries and sub-subsidiaries of parent companies. It may be to secure an interest in competitive or substitute products, to assure supplies of raw materials or to secure a measure of influence in the marketing or distributing channels through which the products flow. This is a particularly convenient method to adopt when a new enterprise is started; but, even with the recent concession for newly formed companies in India, such an arrangement is one that a company promoter is not encouraged to adopt here so long as most companies have to pay super-tax on the dividends received from another company.

In the Chamber's opinion encouragement must be given to the formation of groups on the lines adopted in other countries and, with this object in view, the exemption of inter-corporate dividends from super-tax is necessary and justified.

Question 82.—Do you think that any special provisions are necessary for the assessment of—

- (a) banks; and
- (b) investment companies?

Do existing rules relating to assessment of insurance companies, especially mutual insurance associations, require any change? If so, in what respect?

There is a tendency to treat investment holding companies as dealers in shares and this should be remedied.

Question 83.—Do you think that differentiation should be made between distributed and undistributed profits of companies for tax purposes? If so, on what grounds? What change would you suggest in the present quantum of differentiation in favour of undistributed profits? Should the concession in future be restricted to particular industries?

If the tax concession in favour of undistributed profits is allowed to continue as at present or in a modified form, what measures would you suggest to ensure:

- (a) that retained profits are not used as a device by shareholders of private limited companies to evade super-tax;
- (b) that retained profits are actually applied for productive purposes?

In particular, are the provisions of Section 23A of the Income-tax Act satisfactory? If not, what changes would you suggest?

The principle of differentiation is sound but owing to piecemeal amendments to the Act the practical application of it leaves much to be desired. The Initial and Double Depreciation Allowances are merely a deferment of tax and not a reduction in the ultimate liability. In many cases of an expanding Company where heavy capital expenditure has been incurred and as a consequence of the initial and double depreciation allowances the assessable profits are small, if the dividend when declared is less than the assessable profits the holder of the risk capital may be discouraged and will not be prepared to invest in similar concerns in future. The Chamber feels therefore that in computing the profit for the purpose of rebate or excess dividends the initial and double depreciation allowance should not be deducted.

In the case of trading companies, whether public or private, it is for the benefit of industry and the country as a whole that profits should be retained in the business even though there may be some reduction in the super-tax paid by the shareholders.

With the proposed amendments to the Companies Act it is hoped that profits will be applied for the purpose of the business and not for extraneous matters and the Chamber feels that apart from these provisions each business should be allowed to use retained profits as it so desires with the consequent increase in subsequent profits.

As regards Section 23A which has been the cause of so much controversy ever since its introduction into the Act, the Chamber urges with all the emphasis at its command that this provision should be removed entirely or at least re-designed in such a way that it will not be applicable to companies carrying on a trading business and will include provision for exemptions in other cases where considered equitable. Section 23A was originally introduced to prevent the avoidance of super-tax by investment companies. It should continue to apply to such companies alone.

In any event the present section is unsatisfactory in the treatment of subsidiary companies. Subsidiary companies are within the scope of Section 23A unless the whole of the share capital is held by a company in which the public are substantially interested. Thus when a public company owns more than 99 per cent. of the shares and the balance is held by the Indian public the Section will still be applied. A further proviso is clearly required to the effect that the Section shall not apply when more than 50 per cent. of the share capital is held directly or indirectly by one or more companies in which the public are substantially interested.

Question 84.—Do you think, in view of the fact that profits distributed by a company are subjected to corporation tax, it is appropriate that they should also be charged to super-tax in the hands of shareholders? If not, what are your suggestions in this regard?

See answer to Question 66 which applies here also.

Question 85.—Would you consider that industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies should be required to contribute, from their earnings in the way of income-tax or in other ways, to general revenues?

Yes, certainly.

Question 86.—What measures would you suggest for the greater use of the services of Chartered Accountants for assisting in the determination of the taxable income of assessee? What obligations should be placed on a Chartered Accountant when he certifies a statement of accounts of an assessee for purposes of income-tax assessment? In particular, with a view to minimising evasion of tax, would you recommend that the certificate of a Chartered Accountant should invariably accompany the return for business income over a certain limit? If so, would you suggest that a form of certificate should be prescribed indicating the scope of the check that should be exercised by Chartered Accountants who render the certificate mentioned above. Do you agree that fees payable by assessee to Chartered Accountants for such certificates should be restricted to a schedule to be prescribed by Government?

The primary function of Chartered Accountants is to certify accounts of limited companies for the purpose of the Companies Act and the Chamber would strongly oppose any proposal that this function should be extended to cover certification of accounts for the purpose of assessment to income-tax. When auditing the accounts of limited companies for the purpose of the Companies Act it is the practice of Chartered Accountants to accept certified returns from works, estates, etc., and in the case of many, and in particular the larger, companies to limit their examination of the books to tests of the transactions. Furthermore the detailed transactions are examined by clerks whose knowledge of income tax law is necessarily limited. In any event, the preparation and auditing of accounts for the purpose of the Companies Act differs in many respects from the preparation of an adjusted Profit & Loss Account for Income-Tax purposes.

The number of Chartered Accountants experienced in both auditing and income tax law is still very limited and is likely to remain so for many years while it must be appreciated that, unless the treatment of assessee by many Income-Tax Officers is changed, Chartered Accountants might be held to blame—and liable to the penalties provided by the Chartered Accountants Act, 1949—not only for any omission to disclose items which are manifestly disallowable but also for such items as the Income-Tax Officer may consider as not incurred for the purpose of the business.

Any form of certificate prescribed by Government would have to permit qualifications of the certificate by Chartered Accountants covering all the above points and in consequence would lose much, if not all, of its value.

The costs of Chartered Accountants vary very considerably and any schedule prescribed by Government would have to be based on those of the highest with the danger that the schedule would be applied in all cases even where the costs of the Chartered Accountant were not high and his experience limited.

The Chamber is therefore of the opinion that in any event no schedule of fees should be prescribed by Government for any work done by Chartered Accountants for income-tax purposes.

Question 87.—What changes would you suggest in the present law relating to the representation of assessee before Income-tax authorities (section 61) in order to ensure—

- (i) effective representation of assessee at reasonable fees,
- (ii) a minimum level of proficiency on the part of representatives regarding the subject of income-tax law, rules and regulations?

In the Chamber's view it must be left to the assessee himself to select his representative and to the parties concerned themselves to settle the fee which must be fixed with reference to the circumstances of the particular case involved. These are not matters that can be governed by legislation; nor can legislation create proficiency. The existing provisions of Section 61 appear to the Chamber to be adequate.

Question 88.—Will it assist in checking evasion if the names of the persons who are penalised for concealment of income are published?

On the whole the Chamber is inclined to think this will assist but holds no strong view on the subject.

Question 89.—Do you think that the present practice of excluding from taxable profits, perquisites given to employees of business undertakings results in considerable loss of revenue? If so, please state the perquisites you have in mind, and how they should be dealt with for the purposes of taxation.

No, the revenue involved is inconsiderable and the Chamber would deprecate, as it did in 1951, any proposal to change the law in this respect. In so far as items such as free medical attention, passage costs, office canteen lunches and the like are concerned—and these presumably are the type of “perquisites” this question has in view now that the question of free housing has been settled—it is necessary to bear in mind that these form part of the terms of service of the employee for the benefit of the business in earning profits, are not convertible into cash by the employee and many of them are in one form or another applicable to industrial labour as well as to other staff.

Question 90.—In the case of a company under liquidation, what steps, if any, would you suggest for safeguarding payment of tax dues before any payments are made to shareholders?

In the Chamber's opinion this is a matter for treatment under the Indian Companies Act and not in the context of taxation legislation.

Question 91.—Do you think that, in order to minimise evasion and avoidance of tax, there is a case for conferring larger powers on income-tax authorities? If so, what further powers should be given to them? In particular, should powers to search premises and seize documents and books of accounts be given to Income-tax authorities? If so, what is the lowest grade of officer on whom you would confer these powers?

No. The existing powers are sufficient. The Chamber sees no good reason why all assessee should be classed as dishonest and therefore made subject to wide, far-reaching powers against which, even in their misuse, there is no remedy under any of the laws of the land.

Powers to search premises and seize documents and books of account should not be given to Income-Tax authorities. It should be sufficient in the opinion of the Chamber to empower the Income-Tax authorities to compel the production of relevant documents, the retention of which should be subject to a stated and reasonable maximum period.

Question 92.—What precautions are necessary and possible to prevent the creation of an artificial legal entity—a trust or a private limited company or a partnership, especially family partnership—either for avoiding payment of income-tax or for fractioning of income to escape higher rates? Would you recommend the use of penalty rates of tax to minimise such practices?

Though the Chamber finds it difficult to visualise the abuses which this question may have in mind, it sees no reason why liberty to form trusts, private limited companies or partnerships, should be interfered with provided there is no evidence of tax evasion.

RECOVERY.

Question 93.—In the case of a registered firm, would you advocate recovery of unrealised tax of any partner from the firm as such or from other partners?

Yes. But if any change in the law is necessary it should be restricted to the recovery of tax at the rate applicable on the income of the partner from the registered firm.

Question 94.—Are present arrangements relating to recovery of income-tax adequate? Would you advocate the Income-tax Department having a separate machinery for enforcing the recovery of arrears of tax?

In the Chamber's opinion, yes. In answer to the second part of the question, the view of the Chamber is that adequate machinery for this purpose already exists in the form of powers of collection and certification.

Question 95.—What provisions should be made to ensure timely collection of tax from private limited companies? Do you consider that liability for payment of tax in such cases should be placed upon shareholders of the company in proportion to their shareholdings?

The question indicates an attitude towards private limited companies which seems to the Chamber to be quite unjustified and which is to be deprecated. Please see in this connection the Chamber's reply to Question 83. The Chamber's answer to the second part of Question 95 is definitely in the negative: there is no possible justification in the Chamber's experience for such a suggestion.

Question 96.—If income from any property is included for assessment purposes in the hands of a person

other than the ostensible owner, would you agree to the tax so assessed being also made recoverable from such property?
Yes.

GENERAL.

Question 97.—What concrete measures should be taken to improve the relations of the Income-tax Department with assessee, especially in regard to—

- (i) provision of free advice to small assessee on the following points:
 - (a) maintenance of accounts in a form acceptable to the Income-tax Department; and
 - (b) matters such as filing returns of income, claiming refunds, facilities for tax payment, expeditious disposal of assessments, etc.;
- (ii) provision of information on various matters relating to assessment proceedings, such as, disposal of refund applications, adjournment applications, examination of records, etc.;
- (iii) arrangement of work so as to obviate the necessity of assessee or their representatives having to wait in Income-tax Offices for unduly long periods; and
- (iv) securing of the largest measure of agreement on facts between the assessee and the department at Income-tax Officer level?

The remedy is more one of bringing about a change in the attitude of the Income-Tax Department staff towards assessee in general than of “concrete measures”. As has been observed in reply to Question 77, the preferable course is the training of a cadre of Income-Tax Officers imbued more with the spirit of service to the public and less with the idea that all assessee are dishonest tax-dodgers who are on no account to be helped in determining their liabilities under the Act. In so far as specific remedies are possible, the following might be considered:—

- (i) The provision of more Public Relations Officers in the Department and Income-Tax Officers specially designated to help the public in these directions, with authority to discuss an assessee's difficulties without the inquisitions customarily associated with assessment proceedings.
- (ii) Notices to assessee to produce records, to answer questions, etc., should give more reasonable time and should be delivered with greater promptness when a time limit is prescribed.
- (iii) Income-Tax Officers should be encouraged, or instructed, to organise their programme of work in such a way as to enable them to adhere to the time-table of their appointments with assessee as an ordinary courtesy to the public. In particular, they should avoid being engaged with I. A. Cs. at times of their appointments, as so frequently happens, and making appointments with several assessee at the same time or at such short intervals that they are unable to adhere to the appointed hours.
- (iv) The remedy, as already pointed out, is a more reasonable and less suspicious attitude towards the assessee, better training of, and more, staff.

Question 98.—What changes would you suggest in the existing arrangements relating to:

- (i) issue of notices;
 - (ii) simplification and filing of returns;
 - (iii) levy of penalties;
 - (iv) recovery of tax; and
 - (v) appellate procedure and machinery, particularly with reference to administrative control over Appellate Assistant Commissioners?
- (i) The existing arrangements relating to the issue of notices is satisfactory except that there is frequently an unnecessary time-lag between their dates and their delivery to the assessee concerned.
 - (ii) There should be fewer changes in the form of return than the almost bewildering number of recent years.
 - (iii) There is a tendency, which should be discouraged, to unreasonable recourse to the imposition of penalties.
 - (iv) When it is made plainly known to the Income Tax Officer that the assessee intends to appeal against a decision of the Income-Tax Officer, the latter should hold up demands until the decision of the Appellate Assistant Commissioner or higher Appellate Authority is issued. More reasonable time should also be given in which to make payment of the tax ascertained to be due—occasionally at present as brief a time as three days.
 - (v) Appellate Assistant Commissioners should be wholly detached from the Central Board of Revenue and

should form part of an independent body such as the Appellate Tribunal. Appeals before the Appellate Assistant Commissioners cannot and will not be regarded as satisfactory so long as the officers in question continue to be in a position in which their future progress in the department may be prejudiced if too many of their decisions are in favour of assessees.

Question 99.—(a) Do you think that undue delay occurs at present in the course of assessment proceedings? If so, what do you attribute this to and what are your suggestions for remedying this?

(b) In order that delays of the kind mentioned above do not appreciably affect collection of a substantial portion of the tax due, should any special concessions be provided to assessees to induce them to make advance payment of tax?

(a) Yes. These unnecessary delays are frequently attributable to Section 18A Advance Payments, and provincial assessments under Section 23B being left indefinitely in this provisional state; reluctance of Income Tax Officers to deal with assessments involving losses, or refunds of tax; inattention or delayed attention to the completion of assessment in which agreement has been reached with the assessee; the disinclination of Income Tax Officers to proceed to assessment where a point of doubt is involved and the apparent reluctance of the Central Board of Revenue to give definite instructions in such cases. The remedies are more definite guidance and fewer restrictive directives on the part of the Central Board of Revenue; the positive encouragement of initiative and decision on the part of the Income Tax Officer in doubtful cases; the prescribing of a time limit within which assessments should be completed or referred to the Commissioner for orders and a relentless drive for the completion of long-outstanding assessments; better training—in selected cases by giving them experience overseas of modern methods; and the provision of more and better trained subordinate staff to relieve Income Tax Officers of routine work which limits their accessibility and service to the public.

(b) Only to the extent of the restoration of a higher rate of interest on advance payments of tax, the reduction of which has discouraged prompt completion of assessments; and, as already suggested, a concentrated drive to complete longstanding assessments.

SPECIAL BUSINESS TAXES.

Question 100.—What in your opinion, would be the circumstances which would justify the levy of Excess Profits Tax or Special Business Taxes?

Only the occurrence of emergency conditions such as those brought about by war.

DEATH DUTIES.

Question 101.—What are your main reactions to the Estate Duty Bill at present before Parliament?

As the Estate Duty Bill is almost certain to be passed into law before this reply to the Taxation Enquiry Commission's questionnaire is considered, this particular question is largely academic until actual experience has been gained of the operation of the Act. In these circumstances the Chamber does not think it necessary to re-state the objections to the Bill in general, and in particular to Clause 80, but wishes to emphasise most strongly the absolute necessity for agreements with other countries for the avoidance of double estate duty.

Question 102.—Would you in the matter of rates of levy differentiate between self-acquired property forming the estate of a deceased and property inherited by him?

No.

PART III.—COMMODITY TAXES (Central and State). Customs.

Import Duties.

Question 103.—Do you think that any changes are necessary in the Indian Customs Tariff in respect of—

- (i) grouping of commodities;
- (ii) additions to and alterations in tariff items;
- (iii) correlation with the Import Trade Control Schedule;
- (iv) clarification in nomenclature and in units of measurement or weight?

(i) Although the existing Customs Tariff works reasonably well and does not generally involve importers in great or continuing difficulties, there are undoubtedly anomalies in methods of classification and grouping. For instance, it is sometimes found that the rates of duty applicable to machinery items are different from those applicable to ancillary materials and parts which are essential for the working of machinery. The existing tariff is therefore by no means perfect and it is an open question whether or not it would be desirable for Government to undertake a complete revision. On the one hand, there must be a natural reluctance to depart from a system which works reasonably satisfactorily, and the

introduction of a completely new tariff would inevitably cause difficulties and misunderstandings in the initial stages until such time as the changes were fully understood by all concerned. On the other hand, as stated, there are anomalies in the present tariff and, having been introduced about 20 years ago, it has in the course of time become defective and out of date in the context of modern manufacturing techniques and the increased variety of goods in international commerce.

Should Government decide to investigate the possibility of introducing a revised tariff, the Chamber would draw attention to the fact that during the past few years the subject of tariff nomenclature has been intensively studied by a group of Customs experts drawn from a number of countries in Europe. Their conclusions are embodied in a Draft Revised Tariff Nomenclature, published in Brussels in July 1950, which is in fact a greatly improved version of the schedule on which the present Indian Customs Tariff is based. The improvements include some re-grouping of commodities and a number of additions to and alterations in tariff items, notably in regard to chemicals, textiles, metals and machinery; and the whole may be taken as a consensus of independent expert opinion as to the form which a comprehensive Customs tariff ought to take. If it is decided that the balance of advantage lies in favour of adopting a new tariff in India, the Chamber would suggest that this draft would be the most suitable basis of review.

(ii) The Chamber's remarks with regard to the adoption of a revised tariff cover also the question of additions to and alterations in tariff items. There is one particular complaint which has been brought to the Chamber's notice in this connection however and which, apart from the general question or whether or not a thorough revision of the tariff is necessary, should receive Government's early attention. Item 87 of the Customs Tariff is a miscellaneous item under which all new goods, or goods which cannot conveniently be classified under other items, are placed. The result is that it is now a very bulky item and includes a wide variety of goods which are entirely unconnected. It is submitted that this practice is wrong and that, even though it may be necessary to retain such a miscellaneous item for dealing with new commodities when they first enter into the trade of the country, their inclusion should only be temporary and they should be given a proper place in the tariff as soon as possible. Item 87 in its present form requires revision at an early date.

(iii) In the Chamber's opinion, a close correlation between the Customs Tariff and the Import Trade Control Schedule is essential if the import trade control system is to work efficiently. Indeed, such correlation is considered more important than the question of revising the Customs Tariff, for while the Customs Tariff works reasonably well for purely Customs purposes, there is no doubt that frequent and serious difficulties are caused by disputes about classification arising from the fact that the tariff on which Customs Officers base their assessments of imports is different from that which the control authorities use for the issue of licences. As the Chamber has said, correlation between the two is essential. The best means of its achievement is a matter for expert opinion but the Chamber would direct attention in this connection to the views which were conveyed to the Ministry of Commerce & Industry towards the end of 1952, when Government were proposing to draw up a completely new Import Trade Control Schedule and appointed an Officer on Special Duty for that purpose.

(iv) The units of weight and measurement now employed in the Indian Customs Tariff have been in use for many years and are clearly understood by all engaged in the import and export trade. Any major change in these units would only cause dislocation and inconvenience and would entail substantial expenditure on weighing or measuring appliances.

Question 104.—(i) What considerations should govern the fixation of rates of import duties for different groups or sub-groups of commodities or for special tariff items?

(ii) Have you any modification to propose in the present rates of duties in the light of the considerations suggested by you?

(iii) Do you consider that import duties should be reduced in respect of any specific commodities in order to reduce the scope for smuggling?

(iv) Are there any cases within your knowledge where duties on the constituent parts are higher than on the finished products? Is there adequate justification, in your opinion, for this differentiation?

(v) Do you think that owing to high rates of duties the yield on any commodity has reached the point of diminishing returns?

(i) The primary purpose of a Customs tariff being to raise revenue, the basic consideration in fixing rates of duty must of course be the amount of revenue required. Where protection is not involved, the rates can be deter-

mined by the principles ordinarily governing taxation, the weight of taxation being fairly distributed over the whole body of imports and the incidence being equated between goods of a similar character or which may compete with one another. In general, goods necessary to life should be taxed as lightly as possible, and special consideration should also be shown to raw materials and to semi-manufactured goods which require further manufacture in India before going into consumption.

The principles which ought to govern the fixation of duties on goods requiring protection and on goods on which preferential rates of duty are conceded were laid down by the Indian Fiscal Commission of 1921-22, and they have not been invalidated during the years which have since elapsed.

Over and above the technical considerations, the effect on the taxpayer should be kept constantly in mind and care should be taken to protect the consumer from too heavy a burden and to avoid allowing the cost of living to rise so high as to increase production costs in India to the point of handicapping her export trade.

(ii) On the whole, the present structure of import duties conforms to the principles described above and the Chamber does not think that any thorough or far-reaching revision is necessary. There are of course individual anomalies, and the Chamber would quote the following three complaints which have been brought to its attention and which require remedy—

(a) Manually-operated machines are assessed to duty at 31 per cent. whereas power-operated are assessed at 5½ per cent. It is difficult to see what grounds there are for this distinction and it is suggested that, in the light of Government's desire to encourage cottage and small scale industries it is undesirable that an excessively high duty should be imposed on manually-operated machines, since it is particularly in the small industries that such machines find a use.

(b) Passenger lifts are assessed at 25 per cent. and goods lifts at 5½ per cent. Again, it is difficult to see the reason for the differentiation, and in addition this difference may well lead to attempts to evade the high rate of duty by misdeclaration.

(c) A serious blemish in the thirty-seventh issue of the Indian Customs Tariff is that the addition of a surcharge in 1951 has resulted in awkward fractions (e.g., 19. 17/32). These should be rounded off.

(iii) The Chamber has little information on this subject but it has been suggested to it that the duties on watches and on silk and art silk are so high as to encourage smuggling and should therefore be reduced.

(iv) The Chamber does not know of any such cases, although that of course does not rule out the possibility of their existence.

(v) In the case of fork lift trucks the yield has not reached the point of diminishing returns for the simple reason that, owing to an excessive rate of duty, hardly any yield has in fact begun to accrue so far. Fork lift trucks are classified by the Customs as vehicles and assessed to duty at 31½ per cent. This, in the Chamber's opinion, is wrong and they should either be assessed at 5½ per cent. as mobile cranes or should be given a separate tariff number at a reduced rate of duty. Certainly the present high rate of duty is acting to prevent almost completely the importation of this valuable modern equipment. Representations for a reduction in the duty which were made to the Central Board of Revenue several months ago were turned down without any explanation.

Question 105.—Is the relative use of *ad valorem* and specific duties in the Indian Customs Tariff satisfactory? If not in what respects would you enlarge or restrict the scope of application of either, whether used singly or in combination?

Specific duties have certain obvious advantages over *ad valorem* duties: they save time and labour in valuation and assessment, both to the importer and to the Customs authorities, they afford greater certainty as to the amount of duty payable, and they ensure uniformity of assessment between one consignment and another. Unfortunately because India's imports include a high proportion of manufactured goods with a wide range of values, it is inevitable that her tariff should retain a high proportion of *ad valorem* duties; and the Chamber accordingly doubts if at present there is much scope for an increased use of specific rather than *ad valorem* duties.

The Chamber would suggest, however, that Government might bear prominently in mind the advantages which specific duties have as a means of counteracting unfair trade practices on the part of other countries, such as "dumping". When exporting countries resort to the "dumping" of their products at extremely low

prices, as was a common practice before the second World War, *ad valorem* duties become inappropriate because they add so very little to the reduced price, and in such circumstances specific duties provide the only form of protection.

Question 106.—(i) In what circumstances would you consider "tariff values" a satisfactory basis for assessment of import duties? (Section 22 of the Sea Customs Act.)

(ii) Are there any commodities to which you would extend the application of "tariff values"?

(iii) What changes, if any, should be made in the procedure for determining "tariff values"?

(i) The fixation of "tariff values" for imported goods is an appropriate procedure in the case of items which may be imported under various descriptions or trade names but which are physically the same commodity or have the same constituents; certain chemicals are a case in point. It is desirable that such items should be assessed to Customs duty on a uniform basis but the different descriptions under which they are imported make this difficult and also provide scope for under-invoicing; the problem can best be met, as stated, by the fixation of "tariff values". Again, where the values of particular imports fluctuate materially but are nevertheless readily ascertainable by market enquiries, the assignment of "tariff values" is a useful device.

(ii) As far as the Chamber's information goes, the present selection of items to which "tariff values" are applicable is satisfactory.

(iii) The existing procedure for the determination of "tariff values" would also seem to work quite well and to give interested parties an adequate opportunity of expressing their views.

Question 107.—(i) What changes in your opinion are necessary in the present provision (sec. 30 of the Sea Customs Act) regarding the determination of "real value" and why?

(ii) Would you suggest any specific measures to counter the evasion of import duties through deliberate under-valuation?

(iii) Have the methods of valuation in the Sea Customs Act proved satisfactory in relation to trade through the land customs border, especially on the Indo-Pakistan border? If not, have you any specific suggestions to make in this regard?

(i) The valuation of imports for Customs purposes always presents extremely difficult problems and has been the subject of prolonged controversy in many countries. In the Chamber's opinion, the existing Indian practice for the determination of "real value" works reasonably well. It would be unwise to depart from it and would in all probability merely give rise to fresh complications and problems.

(ii) The Chamber has no suggestions to make on this subject.

(iii) Again, the Chamber has little information and has no comments to offer.

Question 108.—What changes would you suggest in the matter of granting exemptions from, or reductions in, import duties especially in regard to:

- (1) raw materials used for essential industries;
- (2) materials used for scientific research;
- (3) materials imported for charitable and humanitarian purposes;
- (4) materials imported for stimulating desirable activities, such as agricultural development; and
- (5) necessities of life?

In general, the Chamber has no specific changes to suggest and would only remark that, in the context of official Government policies, anomalies do occur in the grant of exemptions from and reduction in import duty. In reply to question 104 the Chamber has drawn attention to the discrepancy in the rates of duty for manually-operated and power-operated machines. The former are assessed at a substantially higher rate than power-operated machines although, since they find an important use in cottage and small scale industries and since it is Government's declared object to promote these industries, there would seem to be a case at least for an equalisation of the rates, if not for the grant of some special concession to manually-operated machinery.

Question 109.—To what extent do you think revenue might be satisfied in the interests of bilateral or multilateral fiscal arrangements such as GATT or the preferences in favour of certain Commonwealth countries.

Revenue should only be sacrificed in return for some material gain, as for example in an exchange of preference.

Question 110.—Under what circumstances should customs duties be used in preference to import quotas as a means of restricting imports?

As a means of restricting imports for the purpose of conserving foreign exchange, the imposition of Customs duties has two main advantages over a system of physical controls: in the first place it eliminates all the labour, trouble and expense involved in the present import licensing system; and in the second, by merely raising the price of the imported article in preference to prohibiting or limiting its importation, it leaves some element of choice with the consumer inasmuch as the imported article is available to him provided he is prepared to pay the price. Although these are substantial advantages however and must have attractions both for Government and the trade, the Chamber does not think that, taking all things into consideration, it is better to regulate the use of foreign exchange by import duties rather than by a system of physical controls. Customs duties are an inflexible instrument and are often maintained long after the need for them has disappeared; secondly, it would be very difficult to determine the precise rate of duty necessary to achieve the desired result and it is not easy to see exactly how this decision would be taken; and finally, abnormally high rates of import duty would provide scope for the exploitation of the market by the indigenous manufacturer and would be detrimental to the consumer and, in the long run, to indigenous industry itself. In view of these circumstances, the Chamber is of the opinion that, for exchange regulation purposes, the balance of advantage lies with the maintenance of physical controls in the form of an import licensing system. The Chamber is opposed to the use of import duties as a means of import control.

The use of import duties as a means of granting protection to indigenous industries is a different question and, in the Chamber's opinion, is quite legitimate. It is essential however that import duties should not be used with this object until a detailed enquiry into the facts of the case has been carried out by an impartial and quasi-judicial body. This function is at present performed satisfactorily by the Tariff Commission and a reference to the Commission should always precede any grant of protection.

Question 111.—In what respects should the present law regarding "drawbacks" and "warehousing" be altered in order to assist the export trade in manufactured goods which involve the use of imported raw materials?

Situated as she is, at a focus of communications to all parts of the Eastern hemisphere, India is in a position to build up an extensive entrepot and export trade and it is essential to the full development of her economy that customs facilities should be provided wherever necessary for merchandise despatches from India, both for re-exports and for goods partly manufactured in India. For this purpose the drawback and warehousing provisions must allow remission of duty on goods re-exported in the same state as when imported, whether re-exported by the original importer or by a purchaser and for similar relief in respect of high duty goods absorbed in the manufacture of goods which are then exported. The existing facilities provided under these sections of the Customs and Excise law seem adequate.

Question 112.—Have you any suggestion to make regarding the administration of the Sea and Land Customs Acts, especially in regard to:

(a) facilities for settlement of disputes arising out of appraisement;

(b) penalties imposed under the Act and the appellate procedure relating to them?

(a) Whatever may be the actual machinery adopted for the settlement of appraisement disputes, the Chamber considers it most important that differences about appraisement should not be allowed unnecessarily to impede the clearance of goods from the docks. In particular, it is completely wrong that, as sometimes happens, the clearance of a large consignment should be held up because of a dispute about the appraisement of a small part of it; either the consignment should be released under bond and the dispute settled subsequently, or that part of the consignment which is outside the scope of the dispute should be permitted clearance.

(b) Penalties for infringements are imposed in a rapidly ascending scale according to the number of infringements committed by the importer concerned. The Chamber would suggest however that there should be a time limit, after the expiry of which a previous infringement will be left out of account in the fixation of penalties for subsequent breaches. It would point out in this connection that Government regulations are nowadays so numerous and complicated that, with the best will in the world, it is practically impossible for even the most honest importer to avoid committing an offence at some time or another. Frequently, these offences are little more than technical breaches and it is not fair that an honest importer should be subject to

steeply increasing penalties irrespective of the frequency with which the offences occur. As the Chamber has suggested, it would be equitable if a time limit were fixed after which earlier offences would not be taken into account; and it accordingly strongly recommends the adoption of this measure.

Export Duties.

Question 113.—Under what circumstances, in your opinion, should export duties be imposed?

Export duties are a menace to the country's existing export trade and to its future prosperity. Even in the case of a raw material or manufactured articles in which the exporting country has a monopoly, the recourse to export duties causes resentment on the part of the foreign consumer and a search for substitute materials. If, on the other hand, the goods concerned are not a complete monopoly, but represent a very large portion of the total world supply, the export tax can still probably be passed on to the consumer, but the rise in prices will act as a bounty to competing manufacturers from other countries who will in addition by under-cutting always be in a position to sell their total production. The increase in prices may also lead to the forfeiture of goodwill and will stimulate attempts to find cheaper substitute materials. Finally, in the case of export goods in which there is considerable world competition, the export tax will probably not be passed on, will become in fact a tax on the exporter and will in the long run reduce exports.

In many cases it has been claimed as a justification of export duties that they are a temporary measure to deal with a temporary situation. It is general experience, however, that once such duties have been imposed it is a matter of great difficulty to ensure their withdrawal and that they tend to continue long after any economic justification there might have been originally has disappeared. Such a position can rapidly cause intense and possibly permanent damage to foreign markets.

The experience of the jute goods industry in this country during the last four years is a classic instance of the dangers inherent in the imposition of an export duty. Although the jute industry in India produces a large proportion of the total world production of manufactured jute goods, it never was, and today is very far from being, a monopoly producer. The greater part of the world raw jute supplies is grown in Pakistan; there is an important and efficient jute mill industry in the United Kingdom and in the Continent of Europe and a developing industry in Pakistan. As a packaging material the leading position formerly held by jute goods in the United States markets has now been taken over by paper bags and there is keen competition from paper, cotton and other textile materials in other markets of the world. Finally, the method of packaging in bags has been seriously affected by the growing use of bulk handling over the greater part of American agriculture and in many industries and trades.

The rate of export duty on Indian Hessian was Rs. 32 per ton in 1946. From 1947 to 1949 it was Rs. 80 and thereafter it increased by rapid stages till it stood at Rs. 1500 per ton in 1950. This very high rate of duty which at one time represented 76.1 per cent. of the Calcutta selling price was maintained till February 1952. In May 1952 it was reduced to Rs. 275 and in September 1953 to Rs. 120.

The main purpose of the duty was to absorb the large profits which were alleged to be available to shippers and importers as a result of the high prices of jute goods following the shortage in raw jute in 1949 and 1950. This it may have done but the immediate reactions in foreign markets were:—

(1) violent resentment on the part of consumers against the Indian Government and the Indian jute industry accompanied by a considerable loss of goodwill;

(2) a rapid switch over on the part of many consumers to alternative packing materials, particularly in the United States;

(3) an immense stimulus to the European jute manufacturing industry which was enabled to dispose of its entire exportable surplus to the United States at the very high rates then prevalent and which was, as a result, enabled to carry out a considerable measure of re-equipment and rehabilitation;

Despite the reduction of the duty in 1952, the proportion of the North American market held by Indian exports of hessian has never recovered and during the first five months of 1953 was only 77.2 per cent. as compared with 96 per cent. in 1947. The imposition of export taxes on other important export commodities such as tea, hides and skins, linseed oil, coal etc., have, though on a smaller scale, all been hindrances to the development of India's export industry.

The Chamber is, therefore, very strongly opposed to the imposition of export duties and is of the opinion that there is a strong case for their complete withdrawal, particularly in the case of exports of jute goods.

Question 114.—*What measures would you suggest to achieve greater flexibility in the rates of duties to accord with the changing conditions of export markets?*

As indicated above, it is one of the great disadvantages of export duties that they tend to be inflexible and they also tend to be retained long after changing conditions justify their removal. In default of complete removal, the Chamber can only urge that Government should show a greater awareness of the need for rapid adjustment in changing trading conditions, but so long as the duties are measured not only by their effect on export trade, but also by their efficiency as revenue earners, it is unlikely that there will be that quick response to altered circumstances which is so desirable if exports are to be maintained.

This question itself is a recognition of the dangers inherent in export duties. There should be no compounding with policies involving problems of this order. The dangers are too serious to be trifled with, particularly in the highly competitive conditions which are now beginning to characterise world markets.

Question 115.—*Would you suggest that the whole or a part of the receipts from certain export duties should be founded for financing schemes for promoting long range development of the export trade, subject to the obligations under GATT?*

The Chamber is opposed to any schemes of this nature. Finance required for the development of particular industries or export trades should be provided from general revenues.

Question 116.—*Would you, in the interests of revenue or from any other point of view, recommend increased participation by the State in import and export trade? If so, what form do you think should such participation take?*

The Chamber is strongly opposed to participation by the State in the import and export trade. World commerce is now rapidly returning to highly competitive conditions and experience of State trading and barter transactions during the war years and since has shown conclusively that the State lacks both the knowledge and the capacity to deal competently with what in such circumstances must be the final criterion, namely the satisfaction of the requirements of the individual customer. The many complaints which have been received since the war about the quality of Indian goods emphasise that only the skilled and careful attention of export specialists combined with the advantages of modern research and marketing methods will retain India's trade in many markets in which she was once supreme. The Chamber cannot too strongly emphasise that State trading is not only certain to lead to smaller revenues from exports, but in fact is very likely to lead to the extinction of the trades which provide them.

Similar objections can be made to the proposal that there should be State participation in the import trade. The Government of India has had many recent examples of the difficulties and embarrassments which are attendant upon efforts to arrange for foreign purchases by inexperienced Government officials or agencies and of the serious financial losses which may result.

Central Excises.

Question 117.—*Do you regard as satisfactory the present selection of commodities for purposes of levying excise duties? If not, what changes would you suggest and why?*

The Chamber has no alterations to suggest in the present list of commodities on which excise duties are levied.

Question 118.—(i) *Have you any changes to suggest in the present rates of excise duties?*

(ii) *Are the provisions regarding valuation satisfactory where ad valorem excise duties are levied?*

(i) The Chamber has no particular comments to make on the rates of duties which are levied under the existing excise arrangements, but they would urge that, in any revision of the excise system, two important matters should receive attention. In the first place, as a result of the manner in which the excise duties have developed, as in the case of tobacco, the duties are in many cases extremely complex, of an arbitrary and illogical incidence, and frequently prevent the orderly expansion of production. The Chamber considers that the opportunity should be taken, in consultation with the particular interests concerned, to rationalise and simplify, as far as possible, the different categories of excise

particularly in the case of the match industry, adopted the principle of differential rates for manufacturers falling into different categories. The Chamber considers that it is undesirable in principle for differential rates of excise duties to be charged on this basis, and strongly urges that in the interests of sound taxation policy excise duties should be levied at a uniform rate and without differentiation as between producer and producer.

(ii) The Chamber has no particular comments and has not been informed of any difficulties arising out of this question.

In its opinion, however, any extension of this system to the tea industry should be strongly opposed as it is considered that excise duty should be maintained at a flat rate per pound of tea. The reason is that the highest prices are fetched for hill grown teas, particularly Darjeeling, and in these areas the cost of production is highest.

Question 119.—*Do you think that the differential rates of duty on different types of unmanufactured tobacco other than flue-cured, should be replaced by a uniform rate of duty? Have you any other suggestions regarding the tobacco excise tariff?*

The Chamber considers that the differential rates of tobacco excise duty should be maintained, and would in this connection invite the attention of the Commission to the views expressed by the Imperial Tobacco Company, of India Ltd. in their Memorandum on this matter submitted directly to the Commission.

Question 120.—*Do you think that the lower rate of duty on the cottage match industry has been helpful to its development? If not would you suggest any change in the existing rates of duties?*

The Chamber has been informed that the lower rate of duty on the cottage match industry has been of assistance to its development.

Question 121.—*Do you think that the arrangements for the assessment and collection of excises in respect of manufactured and unmanufactured commodities require simplification? In particular, please comment on the present system as regards;*

- (a) licensing
- (b) warehousing, and
- (c) transport

of excisable commodities.

The Chamber has no comments save that it has been brought to its notice that Excise Officers in the case of the tea industry do not permit managers full discretion to decide what tea waste and residue tea should be destroyed. The Chamber supports the view of the tea industry that managers should have full discretion to decide what tea waste and what residue teas should be destroyed, or cleared as tea waste after denaturing, and that the duty of the Excise Officers in this connection should be simply to verify the quantity of tea or tea waste destroyed and to ensure that no residue tea escapes out of the garden without paying duty.

Question 122.—*Do you agree that a part of the excise duties may be earmarked for expenditure on research and development schemes designed to improve the quality and marketability of the commodities?*

Yes. Subject to replies to questions 8 and 9.

Question 123.—*Do you think that the imposition of excise duties has affected adversely the development of industries producing excisable commodities e.g., their size and competitive capacity in export markets?*

It is not considered that the imposition of excise duties as such has seriously affected the development of the industries concerned, but attention is drawn to the reply to question 118(i).

There is, however, no doubt that in the case of export commodities during periods when world markets are adverse to the seller, the additional costs involved have tended to prevent the expansion of the market.

Salt Duty.

Question 124.—*Would you recommend the re-imposition of the excise duty on salt? If so, on what conditions?*

The Chamber is strongly in favour of a re-introduction of the salt duty, since this is in line with its recommendation that all legitimate sources of revenue should be tapped and, with that object, that there should be an extension in the field of indirect taxation. A salt duty, like other forms of indirect taxation, would have the great merit of enabling substantial amounts of finance to be raised by means of a relatively slight imposition which in itself would involve very little burden; and, since the mass of the population—the agriculturists and industrial workers—are enjoying a degree of prosperity which

whole they are in a position to pay a duty on salt without hardship and without genuine cause for grievance. Unfortunately, the salt duty has been the subject of violent political controversy in the past and its re-introduction would almost inevitably arouse strong agitation. Consideration should therefore be given to the best means of avoiding such undesirable controversy in the event of the duty being re-imposed, and the Chamber would suggest in this connection that the answer might be to bring salt within the scope of sales tax instead of re-introducing the duty as a specific duty on salt.

TAXES ON THE SALE OR PURCHASE OF GOODS AND ON ADVERTISEMENTS.

GENERAL.

Before attempting to answer separately questions 125 to 134 it will be convenient to deal generally with the growth of sales tax leading up to the position as it now exists and the remedies proposed by the Chamber.

When sales tax was first introduced it was based on the single-point system, the tax being payable on the sale by the registered dealer to the unregistered dealer or consumer. Later, some States adopted the multi-point system and/or combinations of the two systems. Then, to remedy the confusion and difficulties created by differing laws in the several States, Article 286 of the Constitution of India was enacted; but a last-minute addition to that Article not only failed to achieve simplification but actually added to the difficulties previously experienced.

A comprehensive interpretation of the provisions of Article 286 of the Constitution has yet to be given by the Supreme Court. That Court has ruled that Article 286(1) of the Constitution lays down the principle that the State that has the sole and exclusive power to levy a sales tax is the State in which the goods have actually been delivered as a direct result of the sale for the purpose of consumption in that State. However it has not been made clear that only a trader with a place of business within that State can be assessed on his sales in that State. It would be necessary to establish this latter point to restore to Article 286(2) the meaning assumed to have been intended by the framers of the Constitution, namely that the imposition of a State sales tax on a sale of goods taking place in the course of inter-State trade or commerce is prohibited up to the time that the goods are resold in a State by a dealer carrying on business in that State for the purpose of consumption in that State.

Very considerable difficulty arises in the case of the commercial and industrial community as sales tax legislation differs from State to State so that there is a complete lack of uniformity between the several States as regards the rate of tax, the method of application and the goods to which it is applied. Certain goods may be assessed to State sales tax after assessment to Central Excise Duty. Certain goods may be exempted from sales tax in one State but not in another. In some States certain goods may be classified as luxury goods and subjected to a rate of tax higher than other goods. Raw materials for use in a process of manufacture may be taxed in one State but not in another. Goods sold under established trade marks and intended to be sold in small units at fixed prices related to the coinage of the country common throughout the Union of India have to be retailed at different prices in different markets dependent on the local taxation effective at each point. The result is a dislocation of normal trading and the encouragement of abnormal movements of goods from markets with lower tax rates to markets with higher tax rates, leading to extensive evasion of tax. The commercial and industrial community has been put to very considerable trouble and expense in order to ascertain its liability to tax in all cases where its trade or business extends beyond the boundary of a single State.

The minimum remedies to remove some of the foregoing difficulties and make the levy of sales tax feasible are uniformity of rate, character and incidence throughout the Union of India and the restriction of a State's jurisdiction to persons carrying on business within its own boundaries. Even then, however, complications and administrative difficulties would persist if a single-point tax is imposed. Involving as it does the classification and registration of dealers and legislation as to the points at which different types of transactions are to be taxed, the single-point tax is in itself responsible for much of the complexity and confusion hitherto associated with sales tax.

The application of sales tax at a single point only would seem to derive from the conception that as the tax is leviable on commodities sold it is more convenient to collect it at one rather than at several points in the distribution chain. There is, however, another and perhaps more logical conception of sales tax which places the emphasis on the activity of selling goods rather than on the commodities sold and this latter conception forms the basis of the following proposed system which the Chambers strongly recommends.

The mode of collection of such a sales tax would be a levy on the aggregate turnover of every trader in the country without exception in respect of all goods sold by him in India again without exception. The essence of the suggested tax is that there be no exception and that the rate of tax be a small percentage (say one quarter of one per centum) of turnover common to all India. Such a tax would still be a tax on the sale of goods but would be one without the disadvantages previously indicated. Each trader would be taxed at a common rate on all his sales of goods, irrespective of the commodity or commodities in which he deals; he would not be permitted to pass on the tax as such down the chain of distribution to the buyer or consumer; tax would be allowable as a deduction for income-tax purposes and would be absorbed as an overhead expense of his business. No State would be permitted to impose any tax on the sale or purchase of goods additional to the tax payable under the proposed system. The scheme can succeed only if the rate of tax is kept low, so that the burden on the individual is not so heavy as to encourage evasion and so that the effect on prices would be indirect and negligible, in spite of the multi-point nature of the tax. The rate of tax must be kept low also so that goods to be retailed in small units at fixed prices may be related to the coinage. Thus, a maximum rate of tax should be prescribed by law, preferably in the Constitution. To avoid difficulty, the trader should be required to pay tax under the proposed system only to the State in which his place of business is situated; if the trader carries on business in more than one State, then he should be assessed by the State in which each place of business is situated on his aggregate turnover in respect only of that place of business. The advantages of the proposed system may be stated to be:—

- (a) as the consumer is not asked to pay any specific sum by way of sales tax and as the "sales tax" element in the price he pays is negligible and constant, there is no incentive to evade payment;
- (b) the retail dealer is relieved of the very considerable burden of registration as a dealer and of complying with the many formalities imposed under the present system and, as he is not asked to pay any specific sum by way of sales tax on his purchases from the wholesale dealer, again there is no incentive to evade payment or to divert his purchases through abnormal channels;
- (c) the wholesaler dealer is relieved also of the very considerable burden of registration, compliance with legislative formalities, probably in several States, and keeping documentary evidence relating to exempted transactions. He is able to supply his goods to the dealers of his choice, the incentive to evasion again being absent;
- (d) Industry and trade generally would be greatly relieved as regards records, correspondence, invoicing of sales and ordering of supplies. Manufacturers would no longer require to make declarations or otherwise satisfy suppliers as to their classification when ordering raw materials and capital goods. No problems would arise on inter-State transactions and there would be little room for doubt or dispute as to sales tax liability. Sales tax considerations would no longer hinder the normal geographical development of trade;
- (e) for the State Governments, the proposed system offers probably higher nett collections and lower administrative costs, the extent of the collections depending in practice on how wide the taxation net is cast.

Separate answers to Questions 125 to 134 are now given in the light of the foregoing general statement. Before doing so, the Chamber thinks that the attention of Government should be invited to a sales tax system which seems at this juncture worthy of study by those responsible for the architecture of the Indian revenue system. This is the Canadian general sales tax which was imposed in 1920 and is now the largest source of indirect tax revenue in that country. There are today no retail sales taxes in the Canadian tax system; the general sales tax applies to all sales of goods produced or manufactured in Canada or imported into Canada unless specifically exempt by law. All the principal manufacturers and producers of taxable goods in Canada and all the importers of taxable goods into Canada are required to be licensed, and the tax is payable by the licensed vendor, whether producer, manufacturer, or wholesaler, at the time of sale or delivery, and by the licensed importer at the time of entry for consumption. The licensing requirement not only gives the Excise control over the manufacturers and importers who constitute the actual collectors of the tax, but also performs another and valuable function, in that it permits the adoption of a system whereby manufacturers pass materials and semi-manufactured goods from one owner to

another without collection of the tax. This enables free movement of materials and goods still in process to take place without the complications involved in tax accounting. The actual collection of the tax involves the employment of a minimum staff; and the yield is substantial, being, at the present modest rate of tax—which is 10 per cent. *ad valorem*—more than 17 per cent. of the total national tax revenue.

Question 125.—Under the Constitution, the only sales or purchases which can be taxed are sales or purchases of goods. Do you consider that the sales tax should be extended to—

(i) services, so that the tax may be leviable on (a) charges for services proper (e.g., bills from a goldsmith or a printer), (b) charges for both services and goods where the two cannot be readily separated (e.g., hotel bills) and (c) charges for certain types of goods into the price of which service enters as a substantial element (e.g., paintings or photographs); and

(ii) transactions of sale or purchase in stock exchanges and futures markets?

If so, please deal with the administrative and other issues which may arise in the implementation of your suggestions.

The Chamber does not consider that sales tax should be extended to (i) services or (ii) transactions of sale or purchase in stock exchanges. Under the present system sales tax is payable purely on sales of goods. The same would be true under the proposed system. But to avoid difficulty in practice, it might be conceded that where there is a "service" element in the price of goods sold by traders in the market place, such as the product of the goldsmith, the photographer and the printer, then the trader should be required to pay sales tax on his aggregate turnover comprising both "sales" and "service". The point is one of some difficulty, as obviously the fees chargeable by doctors, lawyers and other professional men must be excluded, as should the charges made by an hotel-keeper, as there is no justification for a sales tax on the rent element in his charges.

The extension of "sales tax" to stock exchange transactions would result in a tax akin to a levy on capital; this must be avoided. No tax should be levied on transactions in "futures markets".

Question 126.—(i) The Union alone has the power to levy a tax on sale of newspapers or on advertisements in them. This power has not, so far, been exercised. Would you propose as desirable and feasible (a) a tax on sales only, or (b) a tax on advertisements only, or (c) a tax on both?

As regards (a), it has been urged that, on account of the small price charged for each newspaper, the sales tax would be fractional and cannot be passed on to the buyer, whereas in the aggregate it would be an undue burden on the concern itself. If you agree with this, how would you meet the difficulty?

As regards (b), what classes, if any, of newspapers or advertisements would you exempt from the tax, and what rates of tax, graded or other, would you levy?

(ii) Have you any suggestions to make regarding the taxation of advertisements other than those appearing in newspapers?

(i) (a) The Chamber is of the firm opinion that the taxation of sales of newspapers is undesirable on the grounds that such taxation is repugnant to the ideal of a free press.

A healthy press is of the greatest value to the country as a means of conveying accurate information and of airing views on the many issues which arise from time to time. At present, newspapers reach only a negligible percentage of the population of the country, circulation being confined to a small proportion of the literate population. In most advanced countries, the buying of a daily newspaper is an established habit but this is not so in India. Since it is essential that the Government should have the ear of the people it is obviously in the Government's interest to encourage the sale of newspapers at the lowest possible price. If a sales tax were applied not only would there be a drop in circulation but the spread of public information and literacy would receive a great set-back. It is, however, pointed out that a tax on the sale of newspapers is regarded under the Constitution as a tax distinct from a tax on the sale or purchase of goods and such sales would be exempted under the system advocated by the Chamber but, for administrative convenience, it would be necessary to provide that wholesale and retail dealers in books and newspapers must pay sales tax in common with all other traders.

(b) The Chamber is also opposed to the taxation of advertisements appearing in newspapers. Both the advertisers and the newspapers in which they advertise are already heavily taxed both directly and indirectly and to impose a tax on advertising in newspapers would

therefore hinder the development of sales publicity which is so little advanced in India and which should be encouraged as much as possible in order to promote the distributive functions of the economy, and to expand consumer markets for the country's growing industrial potential. As regards the effect such taxation would have on newspaper revenue, it is pointed out that the advertiser works on a fixed budget which can be increased only if his sales increase. Any taxation on advertisements would therefore be met from the advertiser's budget thereby automatically reducing the amount spent on actual advertising by the amount of the tax which is to be paid. Therefore, although Government would benefit by a certain amount of revenue, the newspaper would automatically suffer a loss of revenue and, therefore, the means to carry out the sales promotion necessary to increase circulation.

(c) In view of the Chamber's replies to parts (a) and (b), no further comment is necessary.

(ii) Opinion is divided regarding the taxation of advertisements other than those published in newspapers. If such advertisements are to be taxed, there appears to be justification for the exemption of the rent element in the case of hoardings and the like.

Question 127.—As regards sales tax generally and, in particular, the sales tax on goods leviable by the States, it is sometimes argued that—since all goods sold in a State must fall within one of three categories, viz., (a) manufactured or produced within the State, (b) transported into the State from elsewhere in the country and (c) imported into the State from abroad—an extension or increase of excise would serve just as well as sales tax for category (a), of octroi or terminal tax for category (b), and of customs for category (c). Do you agree with this view which implies that the sales tax has no specific function to perform in the country's system of taxation? If not, what in your opinion, from the point of view of a correlated tax-structure, is the legitimate place and scope of the sales tax as distinguished from that of excise, octroi and customs?

It is agreed that sales tax as hitherto levied in India is of the same nature as excise duty or customs duty and could be replaced by adjustment of these other taxes, subject to suitable arrangements being made by the centre for apportionment of the proceeds among the States. Each of these taxes is a levy on commodities and similarly sales tax if passed on by the seller to the buyer is a levy on the commodity sold.

Under the system proposed by the Chamber, however, sales tax cannot be passed on as such to the purchaser and represents only a fractional element in the consumer price. It ceases to be a commodity tax and thus acquires a legitimate place in the tax structure of the country, alongside customs and excise duties.

Question 128.—(a) Sales tax is almost invariably levied by the State Governments in terms of the turnover of the dealer over a given period. Since a sales tax leviable on the individual transaction necessitates fairly elaborate accounts, cash memos, etc., which only a small proportion of dealers is equipped to maintain, do you agree with the view that, in Indian conditions, the bulk of the sales tax is likely, for a long time to come, to continue to be leviable on aggregate turnover as distinguished from the individual sale-price?

(b) In most States there are separate laws governing sales tax on petrol. To what articles, if any, do you consider it desirable and feasible to extend the particular system adopted in respect of petrol?

(a) In the opinion of the Chamber sales tax should always be levied on aggregate turnover as a matter of administrative expediency, but when the levy is in the shape of a single or double-point tax and there are numerous exemptions the advantages of assessing aggregate turnover are largely lost. Both the connecting authority and the assessee have to consider the nature of each individual transaction and dealers right down to the retailer have to maintain elaborate accounts for the sole purpose of accounting for sales tax. Only a multi-point tax with few, if any, exemptions can provide the administrative advantages to be expected from assessing aggregate turnover.

(b) The distinctive feature of the majority of the State laws governing sales tax on petrol appears to be that the tax is assessed as a single-point tax on retail sales but there is no uniformity, even in this limited sphere, in character or incidence. To have separate laws governing sales tax in relation to different commodities would merely be to add a further complication to an already confused picture.

Question 129.—(1) In regard to a system of levy based on turnover, is the choice broadly limited to the alternatives hereafter mentioned or is there any other system you would advocate? Under the system you

recommend would sales tax continue to be roughly as significant a source of State revenue as at present? The alternatives referred to above are :

- (i) a relatively low rate of levy at each of almost all points of sale; few dealers excluded and few goods exempted (Multi Point);
 - (ii) a relatively high rate of levy at only one point, viz., the point at which a registered dealer sells either to a consumer or to an unregistered dealer; exemption from tax of sales by one registered dealer to another registered dealer; excluding from compulsory registration of a dealer below a certain limit of turnover; a large number of exempted goods (Single Point);
 - (iii) various combinations of the above.
- (2) Which of the above alternatives would you advocate? Please state your reasons in some detail, comparing merits and demerits from the point of view of (a) the consumer, (b) the dealer, (c) industry, trade etc., generally and (d) Government. Please relate your arguments, as far as possible, to lessons which may be drawn from the actual working of Sales Tax Acts in different States.

(3) In particular :

- (i) as regards (a) above, do you think that the sales tax, or any particular form of it, leads to a greater burden being placed on the consumer than is accounted for by the proceeds which accrue to the Exchequer?
- (ii) as regards (b) above, have you any suggestions to make regarding the simplification of forms, accounts etc., and of the procedure generally in order to make the administration of the tax less burdensome to the dealer? Further, having regard to the cost of maintenance of the machinery for compliance, would you suggest an alternative form of taxation so far as small dealers are concerned?
- (iii) as regards (c) above, has the imposition of the sales tax led to any noticeable change in the organisation of the trade in the country, especially in regard to the size of the business unit, location of head-offices, number of intermediaries, variety of the goods dealt with etc.?
- (iv) as regards (d) above, please examine the financial and administrative aspects, including the scope for evasion presented by the particular system and the difficulty or otherwise of counteracting it.

It is agreed that the choice is limited broadly to the alternatives listed. It will be seen that the system proposed by the Chamber comprises a low rate of levy at all points of sale with no dealers and no goods exempted, being thus a multi-point sales tax system. It is believed that sales tax would continue to be roughly as significant a source of State revenue under the proposed system as under the present system; in fact, if the tax net is widely cast and a method is devised to collect small amounts by way of tax from small traders at low cost (for example, on payment of a licence fee), the proposed system may well be more significant as a source of revenue. No other system of multipoint taxation can be recommended. Simplification of forms would not in itself provide much relief so long as the single-point tax remains, this being the cause of the bulk of the paper work in sales tax accounting. In some States a multi-point tax at too high a rate has tended to put intermediaries out of business, and in the opinion of the Chamber sales tax, under the existing system, may well affect the size of the business unit, location of head offices or variety of goods dealt with, in the future.

Question 130.—In relation to the particular system you advocate :

- (i) should there be special rates of levy, higher than the ordinary rate, for certain articles? If so, for which types of articles?
- (ii) should there be special rates of levy, lower than the ordinary rate, for certain articles? If so, for which types of articles?
- (iii) which articles, if any, should be exempted altogether and why? Please elaborate the principles which, in your opinion, should underlie exemptions.

The essence of the system advocated by the Chamber is that the tax is payable by the seller on his selling operations (in relation to goods) and not on the commodities he sells. Its chief merit is simplicity without the accompaniment of inequalities. Therefore there should be no discrimination between one article and another; there should be only one rate applicable to all commodities and there should be no exempted commodities. The discriminating media in relation to the taxation of commodities should be confined to Customs and Excise duties. If discrimination in favour of essential commodities is desired this should be effected by means of subsidies.

Question 131.—In regard to system, rates, exemptions, etc., what degree of uniformity between the different States do you consider desirable and feasible? Would you bring it about—

- (i) by formal or informal convention;
- (ii) by central legislation promoted at the instance of two or more States;
- (iii) by constitutional amendment, so as to include certain basic matters connected with the sales tax in the Concurrent List?
- (iv) by constitutional amendment so as to include the item of sales tax, as a whole, in the Union List? In the last mentioned case how would you apportion the proceeds? Would this alternative be a practicable proposition from the point of view of the finances of the States?

As has been stressed, uniformity in character and incidence of State sales tax throughout India is regarded as essential. To bring this about, it is thought that constitutional amendment would be necessary, so as to include State sales tax in the Concurrent List. Under the present system, it might then suffice to rewrite Article 286 of the Constitution. Under the system proposed by the Chamber it might be necessary to go further and to include "taxes on the sale or purchase of goods other than newspapers" in the Union list, although it might still be feasible to regulate by formal or informal convention ancillary administrative matters. Much would depend on the ability of the Centre to "sell" the proposed scheme to the States, the co-operation of the latter being an essential factor.

Question 132.—To what extent has any desirable uniformity been achieved in regard to exemptions (in favour of "goods essential for the life of the community") under Clause (3) of Article 286 of the Constitution? What principles would you advocate for deciding the exemptions to be made under this provision of the Constitution? Do you consider that the scope of the provision contained in Clause (3) of Article 286 should be extended also to "essential articles" which had been subject to sales tax before the relevant central enactment came into force?

The list of goods declared essential for the life of the community under the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act, 1952, appears adequate as it stands. Under the present system, it is thought that the scope of the provision contained in Article 286(3) of the Constitution should be extended to include all goods in that list in all States, including goods which were subject to tax before the Central enactment. Under the system proposed by the Chamber, however, all sales of goods would be taxed and the Act would become redundant, as would Article 286 of the Constitution, except to the extent that it should continue to prohibit the imposition of a State tax on goods imported into or goods exported out of the territory of India. The incidence of sales tax on the prices of "essential" and other articles would be so insignificant that the problem of exemptions would disappear.

Question 133.—As regards "sales outside the State", "inter-state commerce", etc. please discuss the adequacy or otherwise of the relevant provisions of Article 286 and suggest remedies for any defects which, in your opinion, have been revealed in the actual working of these provisions.

(b) Please discuss in this connection the desirability and feasibility of the suggestion that purchases only (and not sales) should be taxed, so that the tax jurisdiction of each State might be confined to parties residing within the State. Alternatively, do you consider that purchases should be taxed in certain cases and sales in certain others; if so, how and on what considerations would you define the two categories? In either case, please describe your scheme in some detail and explain the advantages which you claim for it.

Reference has been made in the general statement above to the doubt as to whether States have the power to collect tax from non-resident dealers on inter-State transactions. Whichever way this point is decided, however, the position will still be unsatisfactory. Either States will be given the power to tax non-resident dealers, or certain inter-State transactions will escape taxation altogether. The former decision would result in increased harassment of an already harassed commercial community and the latter decision would entail discrimination in favour of goods imported from another State with consequent further diversion of trade or the imposition of parallel purchase taxes to add to the existing confusion. In the opinion of the Chamber there is no satisfactory remedy to the defects of Article 286.

(b) Fundamentally there is no difference between a sales tax and a purchase tax. A single-point purchase tax if collected from purchasers would remove the problem of States' jurisdiction but would be infinitely more difficult to collect than a single point sales tax as there

are many more purchasers than sellers. If the so-called "purchase tax" were collected through the sellers it would differ little from the existing sales tax and the problem of States' jurisdiction would remain. A single-point sales tax restricted to inter-State transactions combined with a single-point purchase tax restricted to inter-State transactions would be feasible but collection of the purchase tax would be difficult and probably uneconomic. In the opinion of the Chamber neither sales nor purchase tax can be administered efficiently and economically unless applied at a low rate on a multi-point basis with no exempted transactions.

Question 134.—Do you think that lack of uniformity between the States as regards the rates of sales tax and the methods of applying it (single or multiple point) has the effect of raising barriers in inter-State commerce or of including uneconomic diversions of trade? If so, what measures would you suggest to rectify the position?

The Chamber's attitude has already been stated. Lack of uniformity undoubtedly has had the effect of raising barriers in inter-State commerce and of inducing uneconomic diversions of trade. The first essential to rectify the position is complete uniformity in all States. The system advocated by the Chamber not only achieves this uniformity but also introduces all-round simplification.

STATE EXCISES.

Question 135.—(a) In regard to State excise duties and the revenue therefrom, have you any comments or suggestions to make—

(i) on features of importance connected with the system of levy of these duties in different States.

or

(ii) on policies involving various degrees of relinquishment in certain States of the revenue from these duties?

Should there, in this context, be uniformity between different States? If so, in what particulars and to what extent?

(b) Is there proper co-ordination between the levy of of Central excise on medicinal and toilet preparations containing alcohol, etc. and of State excise on alcoholic liquors? If not, what steps would you suggest to ensure adequate co-ordination?

The Chamber has no comments to offer on this question.

General.

Question 136.—Do you think there is a case for vesting in the administration the power to alter, by executive order, the rates of import duties, export duties and excise duties? If so, please indicate in what circumstances and within what limits such power should be exercised.

The Chamber is strongly opposed to the grant to the executive of discretionary power to alter rates of import, export and excise duties. It has already emphasised that these forms of taxation must be used with the greatest care and circumspection and should be imposed solely for revenue purposes. Provision for their variation by executive order would be highly dangerous and would not only encourage a distorted use for other purposes, as for instance for exercising a control over the course of trade, but would lead to frequent variations which would have most detrimental effects on commerce and industry. Furthermore, as a matter of principle, the Chamber considers that it is wrong that in a matter of such overriding importance to the economic life of the community a wide discretionary power should be vested in the executive.

Question 137.—Do you visualise any scope for extension of the field of commodity taxation as a result of the implementation of the Five Year Plan?

The Chamber has advocated elsewhere an increase in indirect taxation and, *ipso facto*, in the taxation of commodities. The scope for such taxation will obviously depend to a considerable degree on the working of the Five Year Plan, for the plan is directed towards an increase in both agricultural and industrial production and both in the public and private sectors; an increased output of commodities and manufactures, with a corresponding improvement in the general prosperity of the country, must obviously widen the sources available for commodity taxation.

Question 138.—What "luxury" articles, if any, would you suggest on which commodity taxes in any of the various forms might be levied at specially high rates?

Almost every type of "luxury" article is already subject to high rates of taxation and the Chamber is of the opinion that, the point of diminishing returns having been reached and in some cases surpassed, there is really little

scope left for an increase in the taxation of luxuries. Government themselves are in the best position to estimate the amount of revenue accruing from such taxation but the Chamber believes that, relative to the income from taxation as a whole, it cannot be great and that, in view of the fact that expenditure upon luxuries is one of the objects of securing a high income, the comparatively small revenue arising from the penal taxation of luxuries is more than counterbalanced by the disincentive to hard work and higher earnings which such taxation involves.

PART IV.—AGRICULTURAL INCOME-TAX.

Question 139.—A few States levy agricultural income-tax, but in almost none is it among the more important sources of revenue; the progress of land reforms will further reduce its yield. Would you, in order to increase the yield from this tax or for other reasons (which may please be specified), make major modifications in the present system of taxation of agricultural income? If so, please indicate the modifications you would make.

Question 140.—In particular, do your suggestions involve—

(a) correlation, and if so, to what extent, of agricultural with non-agricultural income-tax;

(b) alteration, and if so, in what manner, of the levy of land revenue?

As regards (a), if the correlation suggested takes the form of the levy of a single tax on the total of non-agricultural and agricultural income, instead of the present separate Central and State taxes, please deal with the constitutional, administrative and other problems involved, including the apportioning of proceeds among State Governments. Alternatively, if the State Governments continue separately to levy a tax on agricultural income, but the rates of levy are based on the total of the two types of income, agricultural and non-agricultural, what are the specific problems which arise, and how would you deal with them?

As regards (b), please indicate the probable net effect of the suggested measures on the revenues of Government. What administrative or other issues are involved, and how would you deal with them?

Answer to Question 139 and 140:

In the respect the Chamber has nothing material to add to its replies to questions 52 to 54 of the Commission's questionnaire.

There is however a tendency in some States to assess for the most part only large plantations and Zamindaris to agricultural income-tax, and to fail to assess the larger ryots who in view of the present prices of rice, jute, sugar, tobacco, etc. should fall within the ambit of the tax.

Question 141.—How would you determine taxable income in the comparative absence of accounts in rural areas? What treatment should in particular, be given to the following:

(i) expenses of cultivation, harvesting, preparation for the market etc.;

(ii) agricultural losses owing to a calamity or other reasons; (in this connection, would you favour giving the assessee the discretion to choose the alternative of averaging his income over a number of years—say 3 to 5 years—in order to cover good and bad years?)

(iii) depreciation in respect of—

(a) live stock,

(b) implements and carts,

(c) means of irrigation e.g., wells etc.,

(d) buildings?

Here also the Chamber has little experience and restricts itself to observing that the income to be assessed to agricultural income tax should be based on actuals both of income and expenditure of the assessee's accepted accounting period and not on hypothetical calculations and formulae such as the assessing officer's own ideas on the average acreage output of the district concerned and the prices realised for this output.

Subject to the above the Chamber's replies to the questions are as follows:—

(i) Expenses of cultivation, harvesting, preparation for the market etc. All these expenses should be allowed.

(ii) Agricultural losses, etc.

Results average this out and there is no need for special treatment for good or bad years provided that the carry-forward of losses is permitted.

Question 142.—*What rates would you prescribe for agricultural income tax and how would you graduate them? Is it possible to have uniform rates in all the States? What exemption limits would you lay down?*

The rates, which should be uniform for all States, should not exceed the ordinary income tax rate. The exemption limits should be the same as for ordinary income-tax.

LAND REVENUE AND LAND CESSES.

Question 143.—*For areas already under or likely hereafter to be brought under ryotwari or similar tenures, do you consider that land revenue policy should be based on some form of periodical settlement?*

If not, what alternative would you suggest? How would you work it? What would be its probable net effect on Government's revenues?

The Chamber favours the present policy of periodical settlements at which the land revenue payable by the ryot is revised. One alternative to this system would be to settle the revenue payable once and for all; that is, to fix it permanently. The Chamber considers that such an alternative would be open to the following objections:—

- Under a permanent settlement the revenue paid by the ryot would be fixed in perpetuity with the result that Government would not be entitled to an increase in land revenue consequent on an increase in the produce or its value. Similarly the cultivator would not be entitled to reduction owing to a decrease in the produce or its value.
- The demands on the revenues of the Governments in India have increased considerably in recent years and in all probability will continue to increase. The fixation in perpetuity of the land revenue paid by the ryots would deprive Government in the future of any increase in income from this source and would be unjust to the remaining body of taxpayers.
- It would be impolitic for a Government to bind its successors for all time, irrespective of changes in the value of money or of the land and its produce.
- A settlement in perpetuity would involve the risk of a charge of a breach of faith if it were necessary in the future to impose taxes on land.

Two other substitutes for the present system were examined by the Indian Taxation Enquiry Committee of 1924/25, namely, an export or produce tax and the imposition of a tax on capital value. The Chamber notes that neither of these substitute schemes was approved by the Committee.

Question 144.—*If you are in favour of periodical settlements, what modifications, if any, would you make in the practices and principles which have been followed hitherto, and why? In your reply, please refer in particular to the following—*

- Period of guarantee—*Should this be shorter than in the past? Would you suggest longer periods in special circumstances, e.g., when ryotwari tenure is introduced for the first time?*
- Scope of guarantee—*Should a fixed assessment be guaranteed for a specific piece of land (or for a proprietary body, as for instance, in the Punjab)? Alternatively, should a basic rate be fixed and limits guaranteed within which it may vary? What factors would you take into account in varying the rate, e.g., area, nature of crop, yield, prices, etc.?*
- Basis of assessment—*How should the basic rate be fixed? Would you introduce an element of progression?*
- Incentive to production—*Would it be feasible so to regulate assessment as to provide an incentive for—*
 - larger agricultural production;
 - shifts in production, e.g., from cash crops to food crops or vice versa;
 - capital improvements to land?
- Payment in kind—*Would it be possible to provide for payment in kind either partially or in full? Please discuss the advantages, difficulties, etc.*
- Uniformity between States—*In the application of these principles what degree of uniformity between different States would be desirable and possible?*

A full reply would involve a review of the principles and practices at present followed in all the temporary

settled areas. The Chamber feels that it has not the necessary knowledge and experience to undertake such a review, and proposes to limit its reply to two specific points—period of guarantee and payment in kind.

At the beginning of the present century the ordinary term of settlement was 30 years in Madras, Bombay, U.P. and Orissa; 20 years in the Punjab and C.P., and shorter periods in Assam and Sind. As explained in the Resolution issued by the Government of India in 1902, the 30 years' rule prevailed in areas where the land was fully cultivated, rents fair and agricultural production not liable to violent fluctuation. In areas where these conditions did not prevail, settlements were made for shorter periods. During more recent years the tendency has been to extend the periods, and in the Punjab and Uttar Pradesh the term in ordinary cases has been increased to 40 years. The point on which the Chamber wishes to comment is that of the extension of what may be called the maximum term beyond 30 years. It inclines to the view that a period of 30 years, which means that demands of Government are readjusted once in the lifetime of each generation, represents a fair balance between the interests of the land revenue payer and that of Government in its capacity as the representative of the general taxpayer, and doubts whether an extension of 5 or 10 years would be of material benefit to the land revenue payer. It is true that a longer term would be an advantage to the land revenue-payer in so far as it would protect him for a longer period against an increase in the revenue demand. On the other hand, however, it would be a disadvantage in so far as it would deprive him of a reduction in that payment at an earlier date should conditions have so changed as to warrant a downward revision of the land revenue. Again, the longer period might result in sharper enhancements in land revenue which, while they would be otherwise justifiable, would place an undue strain on the cultivator. Further it is most important for the cultivator that the revenue records, including the village map, should be periodically revised and brought thoroughly up-to-date, if the legal presumption of truth attaching to them in the Revenue Courts is to be maintained. For the smaller cultivator in particular there is a danger in extending the term of settlement unless some sure means can be devised for maintaining the accuracy of the village records throughout the period of settlement. The Chamber understands that the demand for an extension of the 30 year term was largely due to two factors. First the conviction among the land revenue payers that a resettlement invariably means an enhancement and secondly the harassment caused to the people by the survey and settlement operations. As regards the former it could be removed by Government making it perfectly clear that a resettlement would not necessarily involve an increase in the revenue demand and would not be postponed solely because it might result in a reduction. The second is largely a matter of the control of the subordinate staff and the up-to-date maintenance of the village records during the period of settlement. The Chamber is therefore in favour of a return to the old position of a maximum term of 30 years.

As regards the payment of land revenue in kind, the chamber considers that the administrative difficulties would render such a course impracticable. These difficulties may be summarised as follows:—

- A large temporary staff would be required at harvest time, for presumably the ordinary revenue establishment would be unable to cope with the work involved, e.g., the division of the crop, its transport to warehouses and its subsequent sale.
- The danger of dishonesty by the temporary staff and of collusion between that staff and the producer would be great and difficult to prevent.
- Large storage accommodation would be required and the risk of damage to the grain prior to its sale would be considerable.
- The sale of the collected produce would be a major undertaking which the Revenue staff would not be qualified to carry out.

Land tenures and past assessments differ so much in different States that it is not desirable to seek any great uniformity. It is, however, a sound thing for each State to ascertain the pitch of assessment in adjacent districts of the neighbouring State or States.

The Chamber has no comments to offer on questions 145 to 150.

Question 151.—*Are there any suggestions which you would make in regard to the assessment of—*

- Agricultural land in rural areas, used for non-agricultural purposes;
- land classed as agricultural but now part of an urban area and used for non-agricultural purposes; and

- (iii) land classed as non-agricultural, whether in rural areas or in urban areas, and used for non-agricultural purposes?

The Chamber suggests that:—

- Land used as sites for hospitals, dispensaries, schools and the like, which yield no return to the owners, should be exempted from assessment to land revenue so long as they are utilised for such purposes.
- Village sites which have hitherto been revenue free should continue to be so.
- Subject to the above exceptions land used for non-agricultural purposes, whether within or outside an urban area, should be assessed at a percentage of its market value. The assessment should be subject to review periodically.

The Chamber has no comments to offer on questions 152 to 154.

IRRIGATION RATES & BETTERMENT LEVY.

The Chamber has no comments to offer on questions 155 to 161.

PART V.—OTHER TAXES (Central and State).

STAMP DUTIES AND COURT FEES.

Question 162.—Under the Constitution—

- the Union is empowered to fix the rates of stamp duties in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts, and
- the States are empowered to fix the rates of all other stamp duties.

As regards both (1) and (2), have you any suggestions to make for the levy of a stamp duty where it is not already levied, or for an increase or decrease of the present rates where a stamp duty already exists? Please give reasons for your suggestions. Are there any general principles which you would propose for adoption in regard to the fixation of rates of stamp duties?

As regards (2), since the rates vary from State to State, what degree of uniformity do you consider desirable and feasible, and how do you propose to achieve it?

If possible, please estimate the net effect of your proposals on the revenue of States.

(1) The Chamber's views on the rates of stamp duty on the various documents referred to are as follows:—

(a) *Bills of Exchange, Promissory Notes, Letters of Credit.*—It is not considered that any alteration in the present rates on these documents should be made. It is considered that these duties are adequate, have stood the test of time, and in addition, their collection is a simple matter and involves little expenditure.

(b) *Cheques.*—The stamp duty on cheques at the rate of one anna per cheque was abolished as from the 1st July 1927. The object of this action was to stimulate the development of the banking habit in India, and it is considered that such encouragement is still desirable and has even greater force owing to the urgent necessity to canalise funds in the hands of the public into the banking system where they are fully utilised for the finance of industry and commerce. The Chamber understands that it has been authoritatively estimated that a stamp duty on cheques at the former rates would, after excluding the costs of collection, yield a very small return and would in any case be attended by considerable practical inconvenience. The Chamber is, therefore, strongly of the opinion that a reversion to the system of Stamp duty on cheques is very undesirable.

(c) *Bills of Lading.*—Although the Indian Stamp Act provides that the stamp duty on bills of lading shall be a minimum of four annas and, although the rate was fixed by the Central Government, the actual rates of duty at the major Indian ports are as follows:—

Calcutta	8 annas
Bombay	4 "
Cochin	6 "
Tuticorin	6 "
Madras	6 "
Vizagapatam	6 "

The Chamber is strongly of the opinion that it is desirable that the rate throughout India should be uniform, and suggests that it should be fixed at 6 annas.

(d) *Stamp Duty on Policies of Insurance.*—There are two points in particular which the Chamber wishes to put forward. These are:—

(1) *SEA INSURANCE* (VIDE CHAPTER 2, SEC. 7 AND ITEM 47-A OF SCHEDULE I). Nowhere is the term Sea Insurance properly defined and there have been various rulings by various Collectors in different parts of the country, including one from a Collector in Calcutta, which stated

that where a policy covered any land risk even though that risk was purely incidental to a sea voyage, stamp duty as per (a) would not be applicable and such a Policy would require to be stamped as per (b). The present position is very anomalous and it is felt that it could be clarified quite simply by referring to Marine Insurance or Marine Insurance Policies instead of to Sea Insurance or to Sea Insurance Policies. The definition of Marine Insurance could then be taken from that appearing in the Insurance Act.

It is not thought that this alteration would materially alter the amount of stamp duty collectable but it would undoubtedly help to remove present anomalies.

(2) *ACCIDENT AND SICKNESS INSURANCE* (VIDE ITEM 47-C OF SCHEDULE I).

There are really two points here, viz.:—

- The stamp duty on Personal Accident Policies proper, and
- That on Personal Accident Aviation Coupons covering merely individual flights, the stamp duty on which is at present covered by notification No. 5 issued by the Government of India on 12th March, 1938, which reads:—

"In exercise of the powers conferred by Clause (a) of Section 9 of the Indian Stamp Act, 1899 (II of 1899), the Central Government is pleased to remit so much of any of the duty chargeable in British India under clause (b) of article 47-C of Schedule I to the said Act on policies of insurance covering accidents to passengers travelling by air as exceeds one anna in each rupee of the amount of premium payable on the policy."

As regards (i) it is felt that the duty is altogether too high as an initial charge, whereas the payment of further stamp duty at renewal seems warranted. There seems no particular reason why this class of insurance should be singled out for special treatment and it is suggested that Section C should be confined purely to Travel Coupons and that the stamp duty on ordinary P. A. Policies should be the same as that for any other class of insurance as laid down under Section 47-B, Schedule I.

As regards (ii) having regard to the low rates which are charged for these Coupons the rate of stamp duty seems to be exorbitant and it is suggested that the rate of stamp duty in these cases should be the same as that for cover on a single railway journey, as laid down in sub-paragraph (a) of Section 47-C of Schedule I.

(e) *Stamp Duties on Transfers of Shares, Debentures, Proxies and Receipts.*—At present the rate of stamp duties on the transfers of shares, debentures, etc. is 12 annas per cent. and, in the opinion of the Chamber, there is little doubt that this rate leads to losses to the Government revenue because of the encouragement which it gives to the holding of shares under blank transfers. It is therefore considered that in this case the Government revenues might benefit from a reduction in the rates which would encourage more frequent registrations.

(f) *Stamps on Proxies and Receipts.*—The Chamber considers no change is required.

(2) As a matter of principle, the Chamber considers that the rates of stamp duties in respect of documents, other than those on which the Union is empowered to fix the tax, should as far as possible be uniform throughout the country, though it is realised that this may be difficult of achievement.

Question 163.—Certain States (e.g., Bombay) levy stamp duties on transactions in forward markets. What is your view regarding the complaint that these duties have tended to affect the business in these markets, particularly that of the middle class traders? If you consider that the levy of stamp duty on transactions in these markets is a suitable and potentially important means of securing revenue, what administrative and other measures would you suggest for the efficient collection of such duties? Alternatively, in place of stamp duties, would you suggest some other form of taxation of transactions in stock exchanges and futures markets? If so, please elaborate your suggestion.

The Chamber is opposed to the levy of stamp duties on transactions in forward markets, stock exchanges, etc. In properly regulated markets, transactions in these exchanges should play a valuable part in the organisation of commodity sales and in mobilising credit, etc., and it is considered that from this point of view a tax on these activities is undesirable.

Question 164.—In this country, the stamp duty is ordinarily a tax on documents which constitute evidence of legal rights. There are, however, certain taxes, such as the entertainments tax, which are sometimes collected in the form of stamps, and suggestions have been made that this system may be appropriately extended to the collection of taxes on the sale of

goods or on other transactions. Do you agree with this view? If so, to what taxes would you extend the scheme?

The Chamber is of the opinion that the extension of the system of stamp duty to the sale of goods, etc., is inappropriate.

Question 165.—What are the more common methods of evasion or avoidance of payment of stamp duty? What means of prevention would you suggest?

Although the Chamber understands that evasion of stamp duties is probably not widespread, it may arise by the declaration of a lower consideration than that actually agreed. Under English law it is understood that the revenue authorities are empowered to ignore the consideration set out in the document and to charge the amount of duty on the real value as ascertained by the revenue authorities. Similar provisions could be introduced in this country, but safeguards would be required against—

- (i) arbitrary assessment by the revenue authorities; and
- (ii) the treating of ordinary commercial transactions in the same manner as inter-family trusts, transfers, etc.

Question 166.—The rates of court fees differ from State to State. To what extent do you consider uniformity in the rates desirable and feasible?

The Chamber is of the opinion that uniformity as between State and State is desirable, but holds no strong views as it appreciates the practical difficulties which may arise.

Question 167.—Have you any suggestions to make regarding the schedules to the Indian Court Fees Act and the rates of levy thereunder?

The Chamber considers that the rates charged in Bengal are reasonable, and that efforts should be made to reduce those charged in other States to that level.

Taxes on Motor and other Vehicles.

The Chamber has no comments to offer on questions 168 to 171

Entertainments tax.

The Chamber has no comments to offer on these questions 172 to 175.

Tax on the Consumption or Sale of Electricity.

Question 176.—A tax on the consumption or sale of electricity is levied in several States in India. Do you consider that this is a suitable tax and may be adopted by other States? Would you restrict it to consumers of energy for domestic purposes or would you extend it to sales for industrial uses also?

A tax on the consumption or sales of electricity is not considered a suitable tax and should not be extended to States which do not now impose it. Electricity is a necessity in a modern city and can no longer be classed as a luxury; its use should be encouraged in preference to other fuels as it is clean and silent and its extensive use for light and fans beneficial to health. Approximately 96 per cent. of the electricity consumed is generated either by hydro-electric plants or steam plants using Indian coal. Any tax on electricity, by increasing the cost of current, will discourage its use and result in greater use of imported fuels such as diesel oil, petrol and kerosene.

If a tax is levied on electricity it should be restricted to users of energy for domestic purposes. To impose the tax on current used for industrial purposes would retard industrial development and would increase the costs of production thus placing a severe burden on industry. Industrial users might find that a tax increased their power costs to a point where it would be more economical to install diesel engines using imported fuel. Industrial modernization and expansion depends largely on cheap and plentiful supplies of electricity. Cheap electricity is particularly necessary for the development of cottage industries.

Question 177.—In respect of domestic purposes—

- (a) should a distinction be drawn between the electrical energy consumed for lights and fans and the energy consumed for other domestic purposes (frigidaires, heaters, radios, etc.)? On what principles would you determine the rates of duty?
- (b) what exemptions would you suggest and on what basis? Would you apply a lower rate of duty to small consumers?
- (a) No distinction should be drawn between electrical energy consumed for lights and fans and for other purposes. To install separate meters for measuring con-

sumption by lights and fans where, owing to the operation of an "all-in" rate, these would not normally be installed would mean that the electric supply undertakings would have to lock up large amounts of capital in meters required solely for the assessment of duty (the cost of an electric meter is approximately Rs. 44 for a single phase A. C. meter and Rs. 95 for a D. C. meter). Any duty on electricity used for domestic purposes should be restricted within reasonable limits such as the normal Sales Tax rate.

(b) The Chamber is of the opinion that there should be no exemptions. All consumers should be treated alike.

Question 178.—If you are in favour of a duty on energy used for industrial purposes, on what principles would you determine the rates of duty? What exemptions would you provide for and on what basis?

The Chamber is of the opinion that electricity used for industrial purposes should not be taxed, and therefore makes no comments on this question.

Question 179.—How would you modify your suggestions in reply to the foregoing questions if electrical energy—

- (i) is entirely supplied by Government undertakings in a State,
- (ii) is supplied by Government undertakings in some areas of a State and private undertakings in other areas?

If electrical energy is supplied by Government undertakings in a State entirely or in some areas it should be subject to the same taxation as that supplied by private undertakings.

Question 180.—What degree of uniformity as between different States would be desirable in regard to the levy of electricity duty? How would you achieve it?

There should be uniformity in regard to the levy of electricity duty between States. At present the only State which taxes all classes of supply is Uttar Pradesh where the rate is 25 per cent. of the gross bill; this has resulted in economic distress, especially in the small type of post-war industries, and industry is unfairly handicapped compared with industry in other States.

The Chamber has no suggestions on how uniformity should be achieved.

Betting and Prize Competition Taxes.

The Chamber has no comments to offer on these questions 181 to 183.

Miscellaneous Taxes and Fees.

Question 184.—Have you any comments or suggestions regarding any other taxes, cesses or fees, e.g., excise on opium, probate and succession duties, registration fees) not covered by parts II to V of the questionnaire?

The Chamber has no comments to offer on this question.

PART VI.—AGRICULTURAL INCOME-TAX, LAND REVENUE AND IRRIGATION RATES.

The Chamber has no views to offer on questions 185 to 208.

Question 209.—Please state your views on the relative merits of octroi and terminal tax, in one or more of the forms in which they prevail in different parts of the country, from the stand-point of—

- (i) the local body concerned: e.g., revenue derived and, in comparison with it, cost of collection, size, and complexity of administration, scope for evasion, etc.;
- (ii) the person who pays the tax: certainty as to amount payable and convenience of collection; and
- (iii) the trade, the consumer, etc.; incidence and effects of incidence, in so far as these can be broadly assessed.

Are octroi and terminal tax mutually exclusive systems, or would it be permissible and desirable, in certain circumstances, to combine the two systems?

On an examination of the relative merits of (a) Octroi (b) terminal tax and (c) any desirable form of combination of the two, which particular alternative would you recommend for general adoption by local bodies? Do any constitutional or legal difficulties stand in the way of implementing your suggestions?

Question 210.—Does your examination lead to the conclusion that both octroi and terminal taxes are unsuitable as forms of local taxation and should, therefore be abolished? If so, what substitutes would you recommend? Do you consider the suggestion that local bodies should be allowed to levy surcharges on sales tax feasible and desirable?

Answers to Questions 209 to 210 :

The Chamber considers that octroi and terminal taxes are unsuitable as forms of local taxation. It is pointed out that the effects of such local imposts on trade and the movement of commodities may be serious and that, from the point of view of local finance, the smallness of the yield and the likelihood that taxes of this nature lead to corruption and evasion make them unsuitable.

The Chamber has no comments to offer on questions 211 to 219.

Question 220.—*The Local Finance Enquiry Committee recommends that the limit of Rs. 250 placed on profession tax by the Constitution should be raised to Rs. 1,000. Do you agree? Would you recommend the wider adoption of profession tax by local bodies and/or State Governments? Which categories of local bodies may suitably levy it, and with what safeguards? Should the levy be compulsory in certain cases, and if so at what minimum level? What modifications, if any, would you suggest in the prevailing forms of levy of this tax? What steps would you take for its better correlation with income-tax, from the point of view of incidence or for purposes of administration, etc.?*

The Chamber sees no justification for a discriminatory personal tax of the nature of a profession tax and suggests that such taxes should be abandoned not only because they are objectionable in principle but also because the yield from them must be very small.

The Chamber has no comments to offer on questions 221 to 228.

Supplementary memorandum presented by the Bengal Chamber of Commerce and Industry.

When representatives of the Chamber appeared before the Taxation Enquiry Commission in Calcutta on the 8th March, they were asked to submit a supplementary note of their views on the following aspects of the Commission's questionnaire:

PART II.

A.—DIRECT TAXES.

(1) Question 58—Section 15C concessions to new industrial undertakings.

(2) Question 61—Replacement of existing assets.

B.—SALES TAX.

The Chamber's views on these points are set out below together with several further comments which the Chamber now wishes to present to the Commission in amplification of the Chamber's written evidence of the 19th September 1953.

PART II.

A.—DIRECT TAXES.

Question 58.—*Section 15C concessions to new industrial undertakings.*

What the Chamber originally sought to point out was that, admirable as the intention might be, the existing Section 15C concessions do not, in practice, afford much benefit to new industrial undertakings for the reason that the profits of new enterprises during their first five years are ordinarily small and after deducting initial and double depreciation allowances which fall to be deducted before profits eligible for consideration under Section 15C are determined, the profits remaining, if any profits do remain, are likely to be negligible. New industrial undertakings normally incur heavy capital expenditure before they can commence business, and the allowances given in respect of initial and additional depreciation are consequently substantial so that, even if considerable profits are earned by the new undertaking, the profits which rank for relief under Section 15C are still small.

Initial and double depreciation allowances, while giving substantial immediate relief to assesses, merely postpone and do not reduce the ultimate liability to tax, and consequently for any real benefit to be obtained under Section 15C, it is important that the allowance under this Section should be given with reference to profits computed before deduction of initial and double depreciation allowances, and if the full benefit of the concessions is to be made available, it is essential that any part of the Section 15C allowance which cannot be set off against profits should be carried forward in the same manner as losses are carried forward under Section 24.

The Chamber's recommendations to the Commission are now therefore that the percentage of capital employed prescribed by Section 15C, calculated separately for each of the five years for which relief is available, should be set off against profits computed before deduction of initial and double depreciation allowances and that if the profits are less than the percentage allowable, the portion which cannot be allowed should be carried forward (as losses are) from end of the five year period.

Question 61.—*Replacement of existing assets.*

As the Chamber understood it, and as the verbatim report bears out, the point made by the Commission

when the Chamber gave oral evidence was that as any tax concessions enabling industry to replace its assets came out of the pockets of the taxpayer, it was reasonable that the assistance so given should be confined to such industries as made, or were likely to make, a positive contribution to the building up of India's economy. The basis of any scheme, the Commission tentatively thought, should therefore be the selection of individual types of industry which are of real long-term value to the country, not of a non-essential or luxury nature; and the suggestion was thrown out that a non-official, disinterested body might be set up to determine which industries should be eligible for the concessions and to what extent. The Chamber undertook to think matter over and to see whether any concrete proposals could be made to the Commission.

After protracted consideration the Chamber has formed the opinion that the selective basis is both unworkable and unnecessary. First, while the staple export industries would obviously qualify for any concessions as essential to the country's economy, not all of their production is necessarily exported and from time to time the quantity diverted to the internal market would vary. It would therefore be difficult, if not impossible, in the context of the replacement of plant and machinery to determine to what extent any tax concessions should be allowed on such an industry. Secondly, many industries produce a variety of products, some of which might be considered essential to the economy, but again in assessing the extent to which concessions should be allowed the same practical difficulties would arise. Moreover, any selection of industries would be bound to operate harshly against what might be termed borderline cases and the Chamber does not consider that the most careful assessment made by any Committee set up for the purpose would be able satisfactorily to overcome these difficulties.

It is appreciated, however, that these concessions cannot be given at large to all industries without impairing the revenue sources of the country and it is suggested, therefore, that where it was decided that an industry was not essential to the economy, the concession granted could be recovered by means of excises and in the case quoted above of industries which are partly essential, excises could be levied on the products which were considered to be non-essential. Such a procedure, it is felt, would recompense the Treasury for the loss of revenue attributable to the tax abatement and would be consistent with the Chamber's own view that direct taxation has exceeded its limits and that the concentration should now be on the wider spread of indirect taxation.

In considering the form in which these tax concessions should be made, the Chamber would draw attention to the recent U. K. Finance Bill which provides for an investment allowance to replace the initial depreciation allowance. Broadly speaking this investment allowance is granted to the extent of one-tenth of the expenditure on the construction of buildings or structures for industrial purposes and to the extent of one-fifth of the expenditure in the case of new machinery or plant. This allowance is treated as a charge against the profits of the year in which the expenditure is incurred and is not taken into account when computing the written-down value of the asset nor in ascertaining the maximum amount on which a balancing charge may be made. The fact that this means of granting a concession has been devised to replace an initial depreciation allowance would indicate that in the United Kingdom substantial initial and other depreciation allowances have not produced the desired results.

Should the selective basis be favoured by the Commission, it is—the Chamber agrees—very necessary that a body entirely independent of and divorced from the executive should be set up to make the selection and—if that is the intention—to determine the degree of assistance to be given to the eligible industries in the replacement of their plant and machinery. This independent body, the Chamber urges, should not be advisory but should be authorised to make final decisions. It should take the same form, the Chamber considers, as the Board of Referees set up under the Excess Profits Tax Act, 1940, and should comprise as may benches as experience shows to be necessary to deal with the claims of those industries whose eligibility for the tax concessions is debatable or marginal.

Had time permitted at the hearing of the Chamber's representatives on the 8th March, it had been their intention to amplify the Chamber's written evidence on the following points:—

Question 48.—*Taxable receipts or gains.*

An assessment on a non-resident shipping company is understood to have been made recently on the basis that such companies are, in addition to being chargeable on profits attributable to freight and passage money originating in India also chargeable under Section 4(1)(a) on profits attributable to freight, etc., originating outside India if payment in respect thereof

is made in India. This represents a departure from the previously internationally accepted practice of long standing, whereby tax has been charged on the profits of such companies in the proportion that the outward freight and passage money only bears to the total freight and passage money.

The Chamber wishes to draw the Commission's particular attention to the hardship and repercussions of this procedure if pursued. Under the existing unilateral relief arrangements in operation in the United Kingdom, relief is limited to income actually arising outside the United Kingdom so that payment of taxes in India on income received in India but arising elsewhere means that relief cannot be obtained in respect of such taxes. The Chamber feels that it has not been sufficiently appreciated that the basis of assessment of non-resident shipping companies heretofore adopted is conventional in that the income of such companies, assessed in India, has been a notional figure determined on the principle that income arises where the freight originates. The Government of the United Kingdom themselves, in common with most other countries, assess on this basis and it is on this basis that they allow unilateral relief in respect of the profits assessed in India, and they are not prepared to allow unilateral relief on profits assessed in India which arise from freight originating outside India but paid in India.

The principle that income arises where freight, etc., originates, although accepted by usage, has never been definitely established and would, in fact, appear to be challenged by the decision of the Supreme Court in the case of the Anglo French Textile Mills v. Commissioner of Income-tax, Madras (Vol. XXIII I. T. R. 1953, p. 101). If, therefore, Government consider that foreign shipping companies should be assessed on the basis of profits received in as well as profits arising in India, then full and complete examination of the question of where the profits actually arise would be necessary, and it appears to be quite illogical that profits arising should, in such circumstances, be assessed on a notional basis which has, heretofore, been adopted for computing the total assessable profits.

The difficulty herein referred to would, of course, be overcome if a Tax Treaty were negotiated on the lines set out in the Chamber's answer to Question 72. In the event, however, of its not being possible to conclude such a Treaty, the Chamber urges most strongly that the conventional method of assessment followed until recently, which appears to be a fair and logical method of dealing with the taxation of shipping profits, should be continued.

Question 63.—Tax concessions to encourage the development of mineral resources.

Since the Chamber's written evidence was presented to the Commission last September, further memoranda by different branches of the mining industries have been submitted in support of the contention that encouragement must be given to the development of the country's mineral resources by means of depletion allowances not limited to 100 per cent. of the original costs and by the treatment as revenue of certain expenditure hitherto treated as capital expenditure in the case of companies working wasting assets.

The necessity and justification for such treatment has already been recognised in the agreement entered into between the Standard Vacuum Oil Company and the Government of India, reported in "Capital" of 11th February, 1954, to be as follows:—

"For a period of five years, Standard Vacuum is allowed a special deductible allowance equal to 33½ per cent. of the net income derived from its share of production before the assessment of income tax. This deductible allowance will be fixed anew for each period of five years on the basis of the relationship between total costs of operation and the total value of production."

These arrangements reinforce the view already expressed by the Chamber that the special position of mineral prospecting and development demands percentage cost depletion allowances not limited to 100 per cent. and that consideration should be given to the extent to which such allowances should be extended to other industries involving wasting assets where the prospecting or development is of a costly and uncertain nature. These factors, namely the cost and the uncertainty, vary in degree between one type of mineral extraction and another e.g., oil, gold, copper and coal; but the principle is the same in each such case and the extent of the justifiable tax concession, which should not be limited to 100 per cent., is merely relative to the differing costs and uncertainties of working the wasting assets.

This principle is well-established in countries which have endeavoured and are endeavouring to develop their mineral resources, for instance in the U. S. A. and Canada; the notable point being that in these countries

the depletion allowances continue so long as the mine or well is being worked and, unlike depreciation allowances, do not cease when the assessee has recovered the full amount of capital invested in the assets. In the relative tax law provisions of both these countries there are, of course, various refinements, qualifications and limitations and special provisions for old and new mines; but for the purposes of this memorandum the salient provisions illustrating the theory underlying the provision for depletion are sufficiently brought out by the following particulars which have been obtained by the Chamber regarding the depletion allowances given to producers (there being others applicable to persons other than producers and to shareholders):—

CANADA

Oil and gas wells.

To operators of producing oil or gas wells—33½ per cent. of the aggregate net profits (minus losses) from production of oil or gas from all wells.

Base and precious metals.

To operators of base or precious metals—33½ per cent. of the aggregate net profits (minus losses) from the production of all mines, or

To operators of mines whose production is to the extent of 70 per cent. or more from gold—the greater of 40 per cent. of the aggregate net profits (minus losses) or \$4 per ounce of gold produced.

Industrial mineral mines.

To operators of industrial mineral mines where the mineral is contained in non-bedded deposits—33½ per cent. of the aggregate of the net profits (minus losses).

Coal mines.

To operators of coal mines—10 cents per ton of coal mined.

Under a more recent provision of the law, Canada has allowed a three-year tax exemption for all new mines.

UNITED STATES

(1) There is a special section—Section 23(m)—of the U. S. A. Internal Revenue Code, which admits for mines, oil and gas wells and other natural deposits "a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance to be prescribed by the Commissioner, with the approval of the Secretary". The allowances prescribed under section 114(b) are:—

Oil and gas wells.—27½ per cent. of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property subject to a maximum of 50 per cent. of the net income (computed without allowance for depletion).

(2) **Coal mines.**—10 per cent. calculated as for (1).

(3) **Metal mines.**—15 per cent. calculated as for (1) and (2).

These depletion allowances, it should be explained, are additional to the ordinary provisions of the law relating to depreciation of assets.

The Chamber cannot too strongly urge that, if India's mineral resources of whatever type are to be satisfactorily developed in the face of competition from other countries, some similar structure of special depletion allowances, additional to depreciation, is essential.

Question 65.—Admissible expenses—Professional men and other self-employed persons.

The Bengal Chamber wishes to add its full support to the following comment made by the Associated Chambers of Commerce of India in the context of Item 65 of the Commission's questionnaire:—

"Attention has already been given in the replies to Questions 17 and 60 to the difficulties experienced by professional men and other self-employed persons in making adequate arrangements to provide for retirement. One method of meeting this serious difficulty would be to allow pensions or contributions to recognised superannuation funds to members or former members of firms. The present inequitable and invidious distinction which exists between directors and other employees of companies, and professional men and other self-employed persons and which only arises because it is impossible for such persons to obtain the protection of limited liability, requires removal by the acceptance of the

principle that suitable provision for the future should be permissible by the allowance, in their case as well as in others, of pensions or provident fund schemes as a working expense. Such action, the need for which is becoming increasingly recognised in other parts of the world, is essential if these vital professional classes are to survive or at the least to continue to attract men of talent and capacity."

Since the Associated Chambers offered these recommendations, the report of the Tucker Committee has been published in the United Kingdom and the recommendation contained in the report is that in such cases annuities up to particular sums will be allowed for tax purposes.

Question 82.—Assessment of Life Assurance Companies.

Instructions have recently been issued for the deduction from interest on Government securities owned by non-resident Insurance Companies not only of income tax, but also super tax. In the case of Life Assurance Companies this means that a deduction of super tax will be made at the rate of 0-4-9 in the rupee as compared with the correct rate of 0-2-9 in the case of a company which is a public limited company or 0-3-3 in the case of other Life Assurance Companies.

These companies are therefore suffering deduction of super tax at nearly double the correct rate on very large sums invested in Government securities, and their life funds are to that extent locked up and not earning interest.

It appears inequitable that tax should be deducted at source at a rate higher than that of the ultimate liability and the chamber suggests that steps should be taken in future to ensure that this is not done.

B.—SALES TAX

1. The proposals contained in the Taxation Enquiry Commission's note on Sales Tax, dated 7th April, 1954 are in outline only and it has been necessary to make certain assumptions in order to visualise the proposed scheme as a whole. The Chamber's interpretation of these proposals is shown on the attached chart (Appendix I).

2. It is noted that whereas the exporting State is entitled to a share of the Sales tax on inter-State dealings in certain raw materials and consumer goods (categories 2 and 3), in the case of luxury goods (category 4) the exporting State does not participate at all in the tax except on sales direct to consumers. Again, the proposed rates of tax are described as ceilings in the first three categories, whereas the rate is apparently fixed in the case of luxury goods. These inconsistencies are not understood, but are only mentioned in passing as they do not affect the conclusions reached by the Chamber.

3. The proposed scheme would be unconstitutional in that *inter alia*, it would restrict the States rights under the Constitution and it would permit of the imposition of tax on sales which take place outside the State. It is considered, therefore, that amendment of the Constitution would be necessary.

4. To be of any assistance this scheme would have to be applied not to a limited selection only but all commodities. Although the commodities enumerated may account in value for the bulk of the internal trade, they exclude many more commodities in which inter-State dealings are very numerous. Assuming the scheme could be put into force without amending the Constitution, the existing problems would remain for all commodities not enumerated and the position would become more chaotic than ever for dealers whose business was not confined to the enumerated commodities. If amendment of the Constitution is undertaken, it is open to doubt whether it would be possible to provide constitutionally for only certain commodities to be singled out for special treatment.

5. It is not considered practicable to work on ceiling rates. States might not necessarily apply the maximum rates and, for example, if exporting State A applied a rate of one pie and exporting State B a rate of three pies and a State importing from the two other States wished to levy the maximum possible tax, the importing State would have to legislate for rates of 11 pies on imports from State A and 9 pies on imports from State B. Such possibilities could result in extremely complicated rate structures in some States. Furthermore, the existence of differing rates in the various States would perpetuate the incentive towards diversion of trade from normal channels. Therefore the rates of tax should not be left as optional ceilings but should be fixed and compulsory.

6. Since States would be relying for part of their revenue on registered dealers and/or consumers in other States they would be vitally interested in the regulations concerning the registration of dealers in all other States. It would seem that to make such a scheme acceptable to the States the regulations regarding the registration of dealers, particularly with regard to the quantum of turnover, would have to be made identical throughout the country.

7. Since exporting States would be concerned with taxing dealers registered in other States, the selling dealer in the taxing State would be required by the taxing State to obtain evidence of the non-resident purchasing dealer's registration. The only method so far devised for this purpose is the declaration from system, which has been in force internally in West Bengal for some time and which has recently been proposed on an inter-State basis under the Interim Relief Measures agreed to by the State Governments for the levy of sales tax on non-resident dealers. The Chamber considers the declaration form system to be wholly impracticable, in that its abuse is inevitable and at the same time it seriously interferes with the smooth flow of trade. Moreover, it places an altogether unreasonable and unfair burden on the shoulders of the selling dealer, since on the one hand he is forced to do part of the tax collector's work and on the other hand he is involved in financial loss when he is unable to obtain, or accepts false, declaration forms from purchasers. The West Bengal Government introduced forms of declaration in 1952 and a year later admitted that business was being done on a large scale in blank declaration forms obtained by unscrupulous dealers under false pretences. They

APPENDIX I

Interpretation of Taxation Enquiry Commission's Note on Sales Tax, dated 7th April, 1954.

Category of goods	Inter-State Sales		Intra-State Sales
	Sales tax chargeable by exporting State	Sales tax chargeable by importing State	
1. Certain essential commodities	No tax	Presumably no tax	Presumably no tax
2. Certain industrial raw materials	Ceiling of 3 pies	Ceiling of difference between 3 pies and rate levied by exporting State	Presumably a ceiling of 3 pies
3. Certain consumer goods, also plant and machinery	(a) On sales to registered dealers, a ceiling of 3 pies (b) On sales to consumers, presumably a ceiling of 12 pies	Ceiling of the difference between the overall ceiling rate of 12 pies and the rate charged by the exporting State	Presumably a ceiling of 12 pies
4. Certain luxury goods	(a) On sales to registered dealers, nil (b) On sales to consumers, 12 pies	On sales by registered dealers to consumers, 12 pies	Presumably a fixed rate of 12 pies

have recently found it necessary to invalidate all unused forms and issue an entirely fresh series, to which monetary ceilings are attached. In the opinion of the Chamber the inter-State declaration system under the Interim Scheme will be open to the same abuse but on a much wider scale. The introduction of declaration forms under the scheme now suggested by the Commission is open to an additional and major objection. For the first time an exporting State would be levying tax on non-resident dealers and therefore for the first time a taxing State would have to rely on declaration forms issued by other State Governments and completed by dealers resident outside the taxing State's jurisdiction. It would seem that neither the selling dealer nor the taxing State would have any means of verifying the authenticity of such declaration forms.

8. For these and many other reasons it is felt that the proposals made in the Commission's note will not be at all helpful in solving the sales tax problems. The Chamber fully appreciates the difficulty with which the Commission is faced in endeavouring to find a solution which will at the same time (a) leave the States with a reasonably free hand, (b) remove the practical difficulties concerning inter-State trade and (c) provide adequate revenue. In the opinion of the Chamber there is no solution on these lines. If the States continue to have freedom of action, chaotic conditions will continue unless inter-State trade is completely exempted from tax, but under the latter condition diversion of trade and the incentive to evasion would become greater than ever. Therefore the only realistic conclusion is that the existing framework should be scrapped and however great the obstacles may be, the States must somehow be persuaded to surrender their rights to freedom of action. The way would then be clear for complete uniformity to be laid down by the Centre.

9. The Chamber therefore urges the Commission to give further consideration to the low-rate turnover tax which has been suggested on page 60 of the Chamber's replies to the Commission's questionnaire, the essentials of this tax being as follows:—

- (1) the method of collecting the tax would be a levy on the aggregate turnover of every trader in the country without exception in respect of all goods sold by him in India, also without exception;
- (2) the rate of taxation must be kept low to discourage evasion and to have a minimum effect on retail prices. It is suggested that it should be a very small percentage (e.g., one quarter of one percentum) of turnover, common to all India;
- (3) although the trader would not be permitted to pass on sales tax as a separate item, as at present, down the chain of distribution, the tax would in fact be passed on as a "sales tax" element in the consumer price in exactly the same way as other overheads are absorbed. It is hoped that this explanation of the intention removes any doubts the Commission may have had regarding the statement made by the Chamber in reply to the Commission's

questionnaire at page 60, para. 2, lines 8 and 9 and page 63, para. 2 of the reply to Question 127, namely that the dealer "would not be permitted to pass on the tax *as such* down the chain of distribution to the buyer or consumer". Since the tax will be absorbed as an overhead expense of his business, the dealer's selling price will already contain a sales tax element and he will not, therefore, be allowed to charge sales tax separately as is the case at present;

- (4) no State would be permitted to impose any additional sale or purchase tax on goods;
- (5) the rate of tax should be prescribed by law preferably in, and by way of amendment of, the Constitution;
- (6) the trader would be required to pay tax only to the State in which his business is situated;
- (7) if a trader carries on business in more than one State, then he should be assessed by the State in which each place of business is situated on his aggregate turnover in respect only of that place of business;
- (8) the tax would be allowable as a deduction for income-tax purposes;
- (9) although not an essential feature of the scheme, small traders may be charged an annual licence fee.

10. When the Chamber's representatives had the privilege of meeting the Commission on the 8th March, the Commission expressed the opinion that the Chamber's suggested system would not provide sufficient revenue. This point has been examined by the Chamber and it has been found possible to make an estimate of the revenue that may be expected. From the attached statement, it will be seen that on the assumption that the goods will have been taxed on the average at least four times before they reach the final consumer, a tax at the rate of $\frac{1}{4}$ per cent. would bring in a revenue of some Rs. 68 crores, which is just over the present total revenue, from this source. An increase to, say, a maximum of $\frac{1}{2}$ per cent. to allow for evasion, would still bring in a considerable surplus and even at this rate there would be no danger of adverse repercussions on the Central Government Exchequer in those cases where the levy of these is appropriate. The attached statement explains how the Chamber arrives at the figure of Rs. 68 crores and also quotes the statistical authorities on which it is based; in this connection, it is pointed out that the assumption that tax will be levied at four stages, on average, before the goods finally reach the consumer is, in all probability, an understatement and it may well be that the figure is six or even higher, in which event there would be a further increase in revenue.

11. The Chamber accordingly trusts that now it has been possible to indicate that there is no likelihood of a loss in revenue, the Commission will reconsider the Chamber's suggested scheme which would go the whole way towards removing the present sales tax difficulties and would be easily workable in practice.

APPENDIX II.

Statement showing the estimated revenue from sales tax under the multi-point low-rate turnover tax system suggested by The Bengal Chamber of Commerce and Industry.

Estimates are based on the approximate value of trade in India in crores of Rupees.

Item	Amount	Amount of Sales Tax at the rate of $\frac{1}{4}$ % at each stage	
		Amount	Cumulative Total
Value of Product—			
Agriculture	4805.00	(a)	
Animal Husbandry	1105.10		
Fishery	37.40		
Forestry	70.00		
Mining	83.30		
Factory Establishment	601.87	(b)	
Small Enterprises	911.00		
Imports	574.44		
Total value of product	8188.11		

Sources and Notes

(a) Final Report of the National Income Committee, February 1954:

Animal Husbandry	9	51
Agriculture	Table 8 at p. 45	
Fishery	14	59

Forestry	Table 28 at p. 106
Mining	" 15 " 62
Factory Establishments	" 17 " 67
Small Enterprises	" 18 " 71

(b) Monthly Abstract of Statistics, Oct.-Nov. 1953: Table 29 at p. 31.

Item	Amount	Amount of Sales Tax at the rate of 1% at each stage.	
		Amount	Cumulative Total
Less value of produce home-consumed, at wholesale prices . . .	3217·97 (c)		
Value of Trade in 1950-51 . . .	4970·14		
Add annual increment for 4 years at the rate of Rs. 307·21 crores per year (Amount of annual increment less trading income) . . .	1228·84 (d)		
Wholesale value of trade in 1954-55 at Stage I	6198·98	15·50	
Less Exports	561·96 (e)		
TOTAL	5637·02		
Stage II (Trading Income in 1950-51 plus amount of annual increments for 4 years)	691·25 (f)		
Value of Trade in 1954-55 at Stage II	6328·27	15·82	31·32
Stage III (Trading Income in 1950-51 plus amount of annual increments for 4 years)	691·25 (f)		
Value of Trade in 1954-55 at Stage III	7019·52	17·55	48·87
Stage IV (Trading Income in 1950-51 plus amount of annual increments for 4 years)	691·25 (f)		
Value of Trade in 1954-55 at Stage IV	7710·77	19·28	68·15

(c) Calculated on the basis of data given in para 2.9, 2.10, 22.13 of National Sample Survey; the Second Round, published in Sankya, March 1954.

(d) The Final Report of the National Income Committee: Table 28 at p. 106 and Table 25 at p. 83.

According to Table 25 page 83, of the Final Report of the National Income Committee, the gross trading income originating from products of agriculture, livestock, fishery, forestry, mining, organised industry, small enterprise and imports in 1950-51 is Rs. 1662·60 crores. National Income figures for the years 1948-49, 1949-50 and 1950-51 (please refer to Table 28, page 106, of the Final Report) indicate that the annual rate of increase is about Rs. 500 crores. The amount applicable to trade is calculated at Rs. 410 crores per year. This amount of Rs. 410 crores is made up of increments in the wholesale value of trade plus increments in the amount of gross trading income. On the basis of 1950-51 the proportion of the value of trade to the amount of gross

trading income is 74·93:25·07. Therefore, Rs. 307·21 crores represents the amount of increment in the value of trade and Rs. 102·79 the amount of increment in the trading income per year.

To arrive at the wholesale value of trade in 1954-55 the total amount of increments to be added to the figure for 1950-51 is (Rs. 307·21×4) crores=Rs. 1228·84 crores.

(e) Monthly Abstract of Statistics, October-November, 1953: Table 29 at page 31.

(f) To arrive at the gross trading income in 1954-55 the total amount of increments (Rs. 102·79×4) crores=Rs. 411·16 crores is added to the gross trading income for 1950-51, Rs. 1662·60.

The total gross trading income in 1954-55 is, therefore (Rs. 1662·60+411·16) or Rs. 2073·76 crores. The amount when split up into three stages comes to Rs. 691·25 crores.

नमो भगवते वासुदेवाय

Bengal National Chamber of Commerce

REPLIES BY THE COMMITTEE OF THE CHAMBER TO PART I OF THE QUESTIONNAIRE ISSUED BY THE TAXATION ENQUIRY COMMISSION.

PART I— TAX SYSTEM

Question 1

A. Taxation in modern States is now-a-days strongly influenced by social and ideological objectives of the Government in power. Classical theories on taxation, which have until some time back governed the taxation policy of the country, do not any longer hold the field, and policies in this respect are now-a-days being determined by the objectives which the Government have in the economic and social fields.

In the opinion of the Committee, the objective of the sound tax policy should be such as would conduce to the economic progress of the country.

B. The Committee consider that, of the various objectives mentioned in the question, the first three are all legitimate objectives, but the emphasis on the one or the other will depend on current conditions of economy. As a matter of fact, over-emphasis laid on one particular objective will adversely react on the two others. The Committee do not deny that it may be necessary in certain circumstances to reduce inequalities of income and wealth, but they have no doubt that too much stress on this objective would discourage incentives to work, to save and to invest—an objective which is no less important.

As regards the last item, the Committee consider that taxation policy should not and need not specifically relate to balance of payment position, as factors underlying adverse balance of payment are amenable to corrections through the pursuit of other objectives referred to in the question.

C. The detailed views of the Committee in regard to modifications of the Indian tax system, having regard to the first three objectives, have been elaborated in reply to questions in other Parts of the Questionnaire. They will here only state that, after the passage of the Estate Duty Act, no more stress need be given to the objective of reducing the inequalities of income and wealth and that there is, on the other hand, a case for relief from the rates for income-tax on higher incomes in particular. The Committee do not also deny the need for countering inflationary and deflationary tendencies, but they are of opinion that prices are not much influenced now-a-days by fiscal policy and the most important thing necessary for the modification of Indian tax system is to provide incentive to work and to save.

Question 2

A. In the opinion of the Committee, "equity" is not a relevant criterion in laying down a sound tax policy. It is very difficult to lay down standards to judge equity. What is more important is the economic consequences of a tax system, and a tax system should be condemned if it lowers standard of living of any section of the community and reduces incentive to work and to invest.

B. The question of securing equity in the Indian tax system does not arise for reasons stated above.

Question 3

The principle of "ability" has been adequately recognised in the Indian tax system.

A. In regard to the direct tax, a considerable element of progression has already been introduced and, subject to the observations made in answer to question No. 1, the Committee do not consider any further extension of the principle necessary.

B. As regards indirect tax which is now the accepted principle of the Indian taxation system, it is an adequate recognition of the principle of "ability" and there is not much scope for its extension.

Question 4

In answering this question, the Committee have considered two views which have been put forward, viz., that lower income groups pay small contribution *per capita* and higher income groups have been left with much unabsorbed taxable capacity. The Committee do not accept either of these views. In recent years, indirect taxes on luxury goods have very much increased as compared to the pre-war levels. If, further, increased cost of living is taken into account, there can be no doubt that the lower income groups cannot bear further taxes. As regards the higher income groups, the rate structure is sufficiently high and no further stiffening thereof can be conceived of.

Question 5

The Committee are emphatically of opinion that the proportion of tax revenue to national income in India cannot be raised any further. The percentage of national income to be collected as tax cannot be a matter of deductive and theoretical determination. The Committee fully recognise that in certain countries the percentage is higher than in India. At the same time, they are emphatically and unreservedly of the view that the current percentage cannot be raised in India because—

(a) the *per capita* income is the lowest in India, except in China as a result of population pressure, and

(b) only a small percentage of the people have comparatively large incomes and the taxable margin in an overwhelmingly large sector of the country is too narrow.

Question 6

Indirect tax currently occupies relatively a larger role in the taxation system than is the case in the tax system of progressive countries. On the other hand in a country like India where the number of persons covered by direct taxation is very small, the burden of direct taxation cannot be increased; on the contrary it needs suitable reduction.

The Committee would, in this connection, like to point out that any loss in indirect tax as a result of modifications in the rates need not cause budgetary problem because the lower price level as a result of the reduction in the rates and consequent higher profits will be reflected in the increased yield of direct tax without any alteration in the rates of the latter.

Question 7

A. No.

B. Railway freights already occupy too high a place in the Indian taxation system. Same is the case also with the rates charged by the Post and Telegraph Departments and any increase in the rates will naturally be reflected in the cost of production of the goods already made rigid by high price of raw materials and high wage structure.

As regards the industries which are being run by the State, the Committee understand that about Rs. 34 crores were invested in them before 1950-51 and that further sums of Rs. 82 crores and Rs. 11 crores have since been added by the Centre and the States respectively, making a total of Rs. 125 crores. The cost of operation of the State undertakings is necessarily very high for variety of reasons, and there is no scope for any further loading on profit made by these State undertakings. It is of course desirable and possible to make these undertakings yield a reasonable return on the capital advanced by the State, but the Committee consider that in the foreseeable future that State undertakings will not be in a position to make any significant contribution to the Public Exchequer.

Question 8

The Committee do not generally object to the funding or allocation of tax receipts for specific purpose. Much will, however, depend on the merit of each particular case. In recent years, such specific and *ad hoc* taxation has been treated as handy by the Government. Mention may be made, in this connection, of the sugar export duty and the cotton excise duty.

Question 9

In regard to the cesses, most of them are generally levied on the different crops. The system of utilising the receipts from the cesses for particular purposes has already come to stay as in the case of tea, cotton, etc. As the matter is not, however, one which can be subjected to theoretical examination, the Committee do not consider that there is much scope for any further extension of the crop cess system. They are of opinion that except for tea where the proceeds of the cesses are utilised for propaganda purposes and, subject to the views expressed by them in reply to question 122, the expenditure incurred in connection with scientific researches should be financed from the general revenue, particularly in view of the fact that the Government have recently set up a number of national laboratories.

Question 10

In the limited field where State commercial and industrial undertakings are in operation or may conceivably operate in near future, the only justification

from the economic stand point is the higher standard of services to the community that may be rendered by these State undertakings as compared to what can be provided by private company of average sound management. The Committee do not therefore, favour any pricing policy being followed by such State undertakings so as to earn a significant revenue. The Committee are of opinion that it should be the policy of these undertakings to render maximum services at a low price and not to aim at earning additional revenues for the purpose of helping the Public Exchequer.

The question of further extension of State undertakings from the fiscal point of view does not arise.

Question 11

Any surplus earned by State undertakings, such as may result without pursuing a deliberate pricing policy based on private earning, should, in the first instance, be ploughed back to the undertakings to the extent the amount re-invested is required for increasing labour productivity. Any additional surplus that may not be usable for such purpose may be paid to general revenues. But as State undertakings are not expected to pursue a deliberate pricing policy, the Committee do not envisage accumulation of large surplus.

Question 12

A. All the factors mentioned in the question should be taken into account.

The Committee are also of opinion that population should be divided into two categories, rural and urban, each in its turn being sub-divided into occupation and income groups.

B. There is no other basis which may be considered in this connection.

Question 13

(a) As mentioned in the reply to question No. 2, it is very difficult to examine the relative burden of the present tax system on the various classes of people.

(b) The distribution of the tax burden among different States is closely connected with the various standards of their financial needs, and any lack of balance in this respect has to be remedied not by changes in the tax system but by differential assistance by the Centre to the States. The question is one which can be properly tackled by the Finance Commission. The Committee may, however, state here that they are not satisfied with the recommendations made by the last Finance Commission.

Question 14

No precise data is available to show the shifts in the distribution of income and the relative incidence of taxation on various classes of people, though it is held in certain quarters that the income of the rural sector has now increased. It can, however, be said that the middle classes have been particularly hard hit.

Question 15

Yes. The details have been given in reply to questions included in Part III of the Questionnaire.

Question 16

The benefits accruing from public expenditure have certainly a bearing on the burden of taxation but it is not possible to establish any direct and workable correlation between the two.

Question 17

Reference has been made in replies to questions included in other Parts to a number of industries, on which the tax burden weighs particularly heavy.

Question 18

The Committee are strongly and emphatically of opinion that in financing development programmes major reliance should be placed on long term borrowing from the community.

Question 19

Of the five-fold methods suggested in the question, the Committee would lay particular emphasis only on the first, namely, economy and rationalisation in expenditure.

As regards prevention of tax avoidance and tax evasion, the Committee consider that there is some but not much—scope for improvement in tax collection by tightening administration. At the same time, they would point out that considerable harassments are already being caused in the collection of taxes and any tightening in administration will be welcomed only to the extent evasion can be prevented without causing unnecessary harassments.

The Committee are definitely against the suggestions made regarding increasing the rates of existing taxes, imposing fresh taxes and developing of non-taxable resources. The Committee, however, generally agree

with the suggestion for re-imposition of salt duty subject to the observations made in reply to Question No. 124.

Question 20

As mentioned in the reply to question No. 18 the Committee would suggest major reliance being laid on long term borrowing for the development programme of the country in the public sector. Unfortunately, the level of taxation has already been raised too high in India and savings in the hands of the community, both individual and corporate, are almost non-existent. It is, therefore, necessary to make a thorough re-adjustment of both direct and indirect taxation, so as to ensure savings from current income. Equally important is the need for making efforts to reduce the cost of production and lower the cost of living.

Question 21

It follows from the observations made in reply to the last question that the rates of taxation, particularly direct tax, should be so revised as to leave far larger savings at the corporate level in order to stimulate capital formation.

As regards the reaction of such a policy on public sector, the Committee would point out that even under existing rates of taxation new money will be required to be created for the *ad hoc* purpose of financing development programmes. The reliefs, which in the opinion of the Committee is necessary to stimulate capital formation in the private sector, will, therefore, require only some extension of the *ad hoc* finance to be created for development outlay in the public sector.

In this connection, the Committee may draw attention to the fact that want of spirit of co-operation on the part of the income-tax authorities and harrassing enquiries by them about the sources of investment of capital, is retarding investment in the private sector to the detriment of the interests of the economy of the country.

Question 22

(i) In the absence of reliable data readily available regarding the rate of new investments in India before the War, it is difficult to compare the rate of that investment with the current rate of capital formation which, so far as the private sector is concerned, is predominantly industrial in India. The amount of capital for industrial purpose, for which consent has been given by the Controller of Capital Issues, will unmistakably show that the investment demand for new investment purpose and, therefore, the annual rate of capital formation is largely on the decline.

While not subscribing to any kind of political partisanship, the Committee are, nevertheless, of opinion that the following factors have accounted for the decline in the formation of capital:

- (a) The psychological factor working in the mind of many entrepreneurs under a system of growing regimentation of industrial economy;
- (b) fixing of prices of raw materials by the Government without reference to their effect on the economy in general;
- (c) continued labour unrest and the demand for increases in wages and for the grant of amenities to labour irrespective of the ability of the employers to meet them;
- (d) steady change in the economy to a buyers' market;
- (e) high rates of taxation; and last but not the least;
- (f) stagnation in the long term investment market.

(ii) There has not been much of a shift in the sources of capital formation in the private sector, except that Corporations are using up all reserves and exhausting their little funds and that institutions like Industrial Finance Corporation are supplying long term capital to some extent.

Question 23

In the opinion of the Committee, tax relief in respect of middle income group would assist the growth of savings and promote consumption consistent with their needs.

Question 24

The Committee feel that the assumption of the Planning Commission of 50 per cent. of the additional output going into investment is rather on the high side as the majority of the people is living on the subsistence level, and at the same time, the population is increasing at the rate of 1½ per cent. annually. The Committee are also opposed to restriction on consumption as this may adversely affect the consumer goods industries.

Question 25

In the opinion of the Committee, a careful assessment of the current economic situation in India would show that, except in limited income groups, the standard of living has not risen in any segment. The question of reducing consumption standards should not, therefore, rise except in the higher income group, in which case, however, the level of taxation is high enough so far as direct tax is concerned, and any further rise will be ineffectual so far as indirect taxes are concerned.

Question 26

In the opinion of the Committee, a tax system may have negative reactions on the productive efficiency. The Committee are not very sure as to how far possible improvement of the tax system can, singly and by isolation, increase efficiency of production. But there are, in their opinion, a number of cases in which the removal of disagreeable features of the tax system will be reflected in varying degrees of improvement of efficiency.

The multiplicity of tax, in regard to which an industry, for instance, has to prepare multiplicity of papers and documents and deal with multiplicity of authorities, definitely increases cost or prevents its available resources being utilised towards improved efficiency.

It is certainly true that the lack of uniformity, as amongst States' taxation on industrial goods or services, will prove a deterrent factor. For themselves, the Committee have always, from business point of view, upheld the principle of uniformity in inter-State taxation (*vide* answers relating to Excise and Sales Taxes).

Question 27

In the opinion of the Committee, the tax system in India may, in certain circumstances, be used to secure some order of priority in the development programme of the private sector. But, for all practical purposes, the scope is confined to actions granting rebate on customs duties on raw materials imported from foreign countries. No broad formula can, however, be formulated in this behalf, each specific case requiring careful and expert investigation.

Question 28

The question raises a policy issue of major importance and the views of the Committee are stated below:

- (a) The scope for influencing over-all demand by a change in tax policy is extremely limited. By its very character, such changes can be only of small magnitude and, the rigidity of consumption standard being what it is in middle and lower income groups, no spectacular variation in over-all demand following tax changes can be expected. In the very nature of things, such demands are more amenable to influence by monetary policy.
- (b) Efforts directed towards reducing consumption and eliminating inessential investment will certainly make for large savings in the hands of the community. But, in Indian conditions, this by itself, will not serve the purpose referred to in the question. Special steps will have to be taken separately to channel increased savings towards productive investment. Besides, as mentioned in answers to some of the previous questions, scope for reducing consumption is extremely limited in India.
- (c) Positive inducements for desirable investments will certainly yield results, but only up to a point. In the lower and middle income groups liquidity preference is much higher in India than in industrialised countries, and investment of these groups is 'interest elastic'.

In answering this question both direct and indirect financial investment has been taken into account.

- (d) A tax policy designed to re-distribute income from the higher income group to lower income groups can only be effective under a programme of free social service system. There is already considerable progression in the direct tax system in India, but the pursuit of such a tax policy is limited by the fact that at a certain point disincentive for investment in risk assumption sets in. What that point is not easily determinable, at least by a rough and ready method.
- (e) In the view of the Committee a tax policy is more significant in its negative results on the economic activity of the community and its functional value as a positive policy is chiefly confined to (c) and (d) above.

Question 29

This question also raises issues of major scientific importance and was partly anticipated in reply to question 28(a). The Committee are of opinion that the average standard of consumption in India being what it

is, a fiscal policy is wholly inadequate to deliver the goods for large investment outlay under a planned economy. Increased reliance should, therefore, be laid on monetary policy than that has hitherto been done. To the extent investment in public expenditure is directed towards short yielding schemes of production, whether of consumer of producer goods, a policy of creating new money appears to the Committee to be justified and, at any rate unavoidable.

As regards control of an over-all character in the various sectors of economy such as wage, price regulation, direction of investment, and volume of production, control is not, in the opinion of the Committee, a policy alternative to fiscal or monetary policy but is coordinate to them. The point which the Committee desire to express is that control should not be so used as to give rise to a mal-adjustment between income and prices or to distribution of income unrelated to the productivity factors.

Question 30

Yes.

A progressive direct tax, the Estates duty and indirect luxury and excise taxes tend to bring about some levelling of income, although for a variety of reasons such levelling is not practically demonstrable in the current context.

Question 31

The Committee have no suggestion to make towards the object specified under the conditions set forth in the question.

Question 32

As already anticipated in reply to question 28(d), a redistribution of income and consequential economic equality is attainable largely under a social security system and, theoretically speaking, the scope for increase in public expenditure on such social services is low in relation to the tax revenue of the Government. The Committee, however, consider that whatever theoretical justification there may be for such increased public expenditure, it would be gravely risky to intensify such policy in the present state of economy for, particularly when there is a severe strain on investment in relation to the development programme of the Government.

Question 33

No, except to the extent of any relief that may be granted in regard to double taxation. The Committee, however, admit that agreement for preferential treatment may be entertained in specific cases.

Question 34

The Committee would answer the question in the negative.

Question 35

The Committee are strongly opposed to tax on capital and their views in regard to the re-introduction of the salt duty and modification of the policy of prohibition have already been stated in appropriate section. The Committee have observations to make in regard to the other taxes mentioned in the question.

Question 36

There is no case for taxing earned increments in the value of agricultural land in view of the economic objectives underlying the development projects and the new agricultural land legislation which has been or is being adopted in every State.

The question may, however, be raised with regard to non-agricultural land in project areas now under process of urbanisation. This process is, however, at its very initial stage and having further regard to the operation of the Estate Duty Act, the Committee do not favour levy of an improvement tax thereon.

Question 37

Suggestions towards increasing the receipts from the existing sources of revenue have been made in reply to question in other parts.

One point, however, on which the Committee would like to lay great stress is that lowering of rate is, in many cases, likely to be more productive in their yield than what they are at the current rates.

Question 38

The considered view of the Committee is that, in most income sectors, there has been a fall in real income in relation to which the tax burden is already heavy and the committee have no suggestion to make to add to the list of existing taxes and thus further deteriorate the current of over-taxation.

Question 39

In view of the observations made in reply in previous question, the Committee would answer this question in the negative.

Question 40

Vide reply to Question 1.

Question 41

Vide reply to Question 28(a).

Question 42

The Committee do not consider that the capacity of a tax system for countering either inflation or depression (by which they understand the influence on general price level or the changes in money supply position in the country) is a matter for determination by its inherent character. On the other hand, the price influencing potential of a tax system is determined by the General level of development of the economy. If the velocity of income and money circulation in India would markedly improve, such influence on the price level shall be exercisable by the tax system, but, pending such development, a tax system will not be a significant factor in relation to prices.

Question 43

The views of the Committee have already been covered in replies to earlier questions.

Question 44

The Committee have one important tax change to suggest, namely, in relation to customs duties. All customs duties should, to the maximum possible extent, be fixed on *ad valorem* basis and not on specific basis. In order, however, to safeguard the interest of consumers of imported goods specific ceiling should be made effective side by side with *ad valorem*. In other words, import duty may be fixed at a particular rate percent or particular value per unit of measurement whichever is lower instead of whichever is higher.

Question 45

The current price situation is not influenced by monetary factors but the inflationary character of the current price level is determined entirely by the current level of costs including the indirect taxes and goods such as import and customs duties. It is in this sense that there is a fiscal arrangement in the present level of high prices. In order to forestall a probable buyers' resistance or the effect of world recession in prices, it is necessary to eliminate this fiscal element in the cost structure to the maximum extent possible.

PART II.—DIRECT TAXES**INCOME TAX****Residence****Question 46**

For reasons mentioned in reply to Question 67, the Committee are of opinion that the category of "Hindu Undivided Family" should be abolished.

They are further of opinion that there is no justification for the retention of the category described as "not ordinarily resident", as there are very few assesseees coming under this description.

Income**Question 47**

Subject to the observation made in answer to the Question 48, the definition of "Income" appears to be satisfactory.

Question 48

Subject to the observations made below, the answer to the first part of the question is in the negative.

The Committee are, however, of opinion that the agricultural portion of dividend in the hands of a Company distributing the same should be considered to be agricultural income in the hands of the recipient shareholder also, and should, as such, be exempted from Central taxation.

Objections have been taken to the proposal for taxing capital gains on the ground that it would retard the formation of capital. It has also been stated that in view of the Estates Duty Act having already been passed, there is no longer any pressing need for taxing capital gains.

While there is undoubtedly some force in these contentions, the Committee would also draw attention to the very high rates of income-tax on higher incomes, which are very much regressive in character and retards formation of capital to a much greater degree than would be the case if capital gains are taxed. They are indeed of opinion that capital formation will be encouraged if these high rates are suitably reduced simultaneously with taxing of capital gains beyond a certain minimum limit.

Question 49

No comments.

Question 50

No change is necessary. "Bonus shares" should not be included in the definition of "dividend".

Question 51

It has been brought to the attention of the Committee that considerable difficulties are being experienced in the application of Sections 42 and 43 of the Income-Tax Act and that the interest of persons engaged in foreign trade are being affected adversely. In particular, no uniform practice is observed by the Income-tax Officers in interpreting the expression "business connection" and other provisions of the Sections also. The Committee would, therefore, suggest that rules should be framed by the Central Board of Revenue determining the liability of the exporter in cases covered by Sections 42 and 43 and also defining "business connection".

Question 52

The definition of "Agricultural Income" appears to be quite satisfactory and does not require any modification. Difficulty arises only in the application of the principle of spontaneous growth of agricultural produce. There can be no doubt that the same income should not be taxed twice once by the Central Government and again by the State Government and there should be a machinery set up jointly by the Central and State Governments for making mutual adjustments.

Question 53

The Committee are not in favour of integrating agricultural income with non-agricultural income for rate purposes.

Question 54

No.

Question 55

The Committee would prefer that income should be averaged over a number of years where receipts are irregular and fluctuating.

Exemptions**Question 56**

The Committee do not think that the present provisions regarding exemption of charitable and religious trusts require any modification.

Question 57

No comment.

Question 58

The concessions given to new industrial undertakings under Section 15C of the Income-tax Act should be continued.

The concessions have not been made infructuous as a result of initial and extra depreciation allowances which are allowed only on new machineries and buildings, while some of the new undertakings have old machineries and buildings in respect of which these allowances are not operative.

Besides, the value of the concessions under Section 15C as an incentive to new industrial development cannot be exaggerated.

The Committee would further suggest that the concessions should be extended also to all industries which are started within a period of 10 years from 1st April 1948, and that the concession should apply to the assessments for 10 years instead of for 5 years as at present.

Question 59

It is not clear from the terms of the question whether relief beyond avoidance of double taxation is sought in respect of profits of foreign branches of Indian banks. It would seem fair, however, that this question (whether limited to relief of double taxation or not) should be regarded as part of the wider question of encouraging exports, invisible trade and other forms of foreign exchange earnings. Any policy of concessional treatment, if decided upon, should be equally applicable to insurance companies and shipping companies also operating and making profits abroad; and banks as such do not seem to call for any special treatment.

Question 60

Yes. At present one-sixth of the income paid as life insurance premium, subject to a maximum of Rs. 6,000, is exempted from taxation. This rule regarding exemption from tax of life insurance premia was made long ago, since when the general price level has increased many times. In consideration of the corresponding fall in the value of money, the exemption limit should, therefore, be raised to 1/5th of the income instead of 1/6th, as at present, subject to the maximum of Rs. 12,000.

Further, in view of the recent enactment of the Estate Duty Act, people will have a growing tendency to invest their income in taking out Life insurance policies rather than buying real properties, if the present limit of exemption from tax of life insurance premium is raised, thereby placing more funds in the hands of the Government and helping implementation of the Development Plan.

Allowances.

Question 61

(i) Yes.

The Committee are in favour of the grant of larger depreciation allowances by treating the excess of replacement cost over original cost as revenue expenditure.

(ii) The fundamental justification for assistance has been furnished by the Commission themselves in Question (i) above. It is not possible for many of the industrial concerns to secure the necessary finance entailed by the increased costs of replacements of assets. It cannot be gainsaid that the economic development of the country will be held up if the industries are not able to replace new and modern machinery with higher efficiency due to lack of necessary finance. Besides, the financial value of the assistance is also not very great, except that payment of the tax is deferred.

(iii) The Committee are of opinion that, if adequate depreciation allowances are granted by the Government, they would be perfectly justified in requiring the industries concerned to bank the amounts, so allowed, separately in a joint account with the Government as was the practice followed at the time the Capital Issue Control Scheme was in operation.

Question 62

No.

Question 63

From the nature of its operations, the mining industry consumes the whole of its capital in the course of production. On the exhaustion of a mine, apart from the minor amount represented by the residual value of recoverable machinery, the capital invested therein, including extensive surface buildings, is totally lost. To enable the mining industry to set aside sufficient funds to develop and work new mines and deeper seams when existing working are exhausted, a special form of depreciation allowance should be granted. For the sake of simplicity and administrative ease, the Committee would suggest a percentage depletion rate.

The object of any such allowance should be to write off the cost of all capital assets whose life is limited by the life of the mine. The value of land and mining rights, exploration and the cost of works which are likely to become valueless on exhaustion of the mine should be aggregated, and the resultant figure should be subjected to an initial allowance of 10 per cent. and an annual allowance of 5 per cent., such annual allowance being calculated on cost and not on the written-down value.

Question 64

The Committee are in favour of providing specific allowances for family and dependents who are the immediately direct relations of the assessee. They are of opinion that, if this is agreed to, it may not be necessary to exempt the first slice of income from tax.

In regard to providing specific allowances to family and dependents, the Act should specify the particular categories of dependents for whom allowances should be granted and, if necessary, the total number of dependents also should be fixed.

No separate treatment to Hindu Undivided Family is necessary, as the Committee are of opinion that this particular category should be abolished.

Question 65

(i) In addition to the items of expenses now allowed, there should be specific provisions for allowance of the following items of expenses:—

(a) Motor Car Expenses—

In the matter of carrying on of professional or business activities, the maintenance of a car is now a days indispensable. Though some times cars are also utilised for personal purposes, such occasions are very rare, and the Committee are of opinion that there should be no hair splitting as between the expenses incurred for carrying on the professional or business activities and expenses for personal use.

(b) Entertainment Expenses—

Such expenses are often necessary for promoting maximum interests of the firms and should be allowed.

(c) Gratuity, Bonus, Commission, etc.—

Payment of gratuity, bonus and commission is often necessary in the interest of the firm and, besides being sometimes statutorily enforced, are also paid as reward to the efficient and honest workers.

(d) Partners' Expenses—

When Partners go out on inspection to Branches, their Boarding and Lodging expenses should not be considered as personal expenses.

(e) Subscriptions—

Subscriptions paid by professional men to Chambers of Commerce and other institutions for membership should be charged against Income. Such expenses are, at present allowed to business firms.

(f) Legal Expenses—

Legal expenses incurred in connection with appeals before the Appellate Assistant Commissioners and the Income-Tax Appellate Tribunal and Reference before High Courts and the Supreme Court, as well as Legal expenses incurred in connection with any business affairs of an assessee (not being for acquisition of capital assets) including prosecution of defence of persons in any proceedings relating to any matter connected with business, should be allowed.

(g) Cost of renewal of leases.

(h) Patent and Copy-right expenses.

(ii) Expenses which are now admissible are all business expenses and should be continued to be allowed.

Rate Structure.

Question 66

(a) The Committee are not in favour of combining Income-tax and Super tax into a consolidated levy.

(b) (i) Assessee—

Assessee will not derive any practical benefit from this combination except that, in the matter of exemptions, they may get rebate at a high rate while paying the tax also at a higher rate. On the other hand, there would also be a possibility of lower income being assessed at a high rate.

(ii) Administration—

The advantage, so far as administration is concerned, would be the facility in computing the tax liabilities.

(c) The degree of progression in the present rate structure is not quite satisfactory. While incomes in the lower groups would deserve a lower rate, the high rates of tax, both income-tax and super-tax, in the higher slabs of income definitely retard the formation of capital by destroying the incentive to work and to make profit.

As the Committee have stated in their preliminary memorandum, private enterprise cannot thrive under a system where all incomes exceeding Rs. 1.5 lakhs are taxed at the rate of 0-12-6 in the rupee with a surcharge of 1/20th of the tax, and it is essential that the rates on higher incomes should be considerably reduced and the ceiling, at which the maximum rate has to be charged, should be raised to a much higher figure than at present. The Committee sincerely hope that the Taxation Enquiry Commission will consider this aspect of the question very carefully.

(d) No comments.

(e) No.

The surcharge, as now levied, is automatically graded as the rates of tax are graded. No further gradation is, therefore, called for.

Question 67

(i) Individuals—

The exemption limit for individuals has necessarily to be changed from year to year according to the prevailing economic conditions and the need for revenue on the part of the Government.

(ii) Hindu Undivided Families—

In considering the question of the exemption limit for Hindu Undivided Families, the Committee would draw attention to the fact that the Undivided Family, as a separate category, is being taxed only in the case of Hindus and that, according to the present system, the incidence of the tax falls, in many cases, on the members of a Hindu Undivided Family more heavily than on other assessee. Though it is true that the taxable minimum is double in the case of a Hindu Undivided Family, the concession is actually of no value when the family consists, as it usually does, of more than two members.

The Committee are, therefore, of opinion that the Hindu Undivided Family, as an entity, should be abolished.

ed and the persons, who are at present taxed as members of such a family, should be assessed as partners of a firm.

DIFFERENTIATION

Question 68

(a) Yes.

The economic justification for the distinction is that an assessee has to exert himself for earning an income while in the case of certain particular forms of income he has not to make much effort himself. The distinction should be continued in order to provide an incentive for profitable work.

(b) Yes.

(c) The quantum of relief now afforded should be extended rather than reduced and the maximum amount of relief should be increased at least to Rs. 10,000 instead of Rs. 4,000 as at present.

MISCELLANEOUS

Question 69

The Committee are of opinion that the basis of valuation of stocks for assessment purposes, viz., "the cost or market value whichever is lower" should be followed.

Question 70

As already stated, the Committee are in favour of the abolition of Hindu Undivided Family as a category.

Question 71

Exemption from income-tax should be allowed in respect of such part of Managing Agency commission as may be voluntarily surrendered by Managing Agents.

While no safeguard is necessary in case of "bona-fide" surrender, the Committee would suggest that provision may be made so that no such commission as may be voluntarily surrendered, may be recoverable in any circumstances in the future.

Question 72

The Committee consider that the Double Income-tax Avoidance Agreements between India and Pakistan may be used as the model for similar Agreements with other countries.

It needs hardly be stressed that a person should not be made to pay tax on the same income in two countries. The country in which the income originates must have a preferential claim in the matter of levying tax on that income. In the matter of taxation of foreign income in India, therefore, such income should be considered for the purpose of rate only. The important point, in this connection, is to find out the country where the income originates, on account of some sort of business connection between two countries or as the result of a continuity of processes of activities between the two countries. The schedule to the Double Income-tax Avoidance Agreement between India and Pakistan appears to be a satisfactory one and this schedule may be followed with such adjustments as may be necessary.

A further important point which the Committee would like to stress is that the difference in the quantum of foreign income computed in the two countries should be left out of consideration. It will be sufficient if evidence is produced before Indian Tax Authorities that the foreign income has suffered taxation in the country of origin.

Question 73

(a) The present law relating to determination of "bona fide annual value" of property and deductions allowed from it, is on the whole satisfactory, except that in the case of property let out on long lease, the annual value is now being determined on the "notional" rent receivable from year to year rather than on the actual rental value. This should be rectified.

(b) As regards the deductions, the Committee are of opinion that the following items should be included:—

- (i) Owner's share of Municipal tax, in addition to the occupier's share.
- (ii) Expenses for maintenance of lifts, electric pumps, tubewells, etc., and the depreciation allowance on their costs and the cost of passage electric lights.
- (iii) Increase in the repairing charges from 1/6th of the bona fide value to 1/4th on account of the high cost of repairs.
- (iv) Such portion of unrealised rent, about the collection of which there is no possibility, subject to the proviso that any portion of such rent subsequently realised should be included in the bona fide rent value in the year of collection.

(v) Cost of litigation, excluding proceedings relating to title.

Question 74

The Committee would answer both the parts of the question in the affirmative.

Question 75

The Committee would suggest that provision should be made for according special treatment in hard cases where assessee are not able to make advance payments due to lack of fluid resources.

Question 76

The Committee do not object very much to the principle underlying Section 34. But they have two observations to make in this connection.

In the first place, they regret very much that the Amendment Act of 1953 has given retrospective effect to the provisions of sub-sections (1), (2) and (3) of the Section, as previously amended in 1948, thereby validating notices issued under the Section and the assessments made in pursuance thereof for the assessment years prior to the 1st April 1948.

In the second place, attention may be drawn to the fact that, in regard to the rectification of mistakes to be done under Section 35, having the effect of enhancing an assessment or reducing refund, there is a provision of giving notice to the assessee of any action to be taken and of a reasonable opportunity being given to him of being heard.

The Committee would suggest that, before any action is taken under Section 34, a similar procedure should also be followed and the Section should be amended accordingly.

Question 77

No comments.

Question 78

The Committee do not support the proposal that the Appellate Tribunal should be allowed to enhance assessment in the same manner as the Appellate Assistant Commissioner. There is no justification for vesting the highest judicial body with executive functions. This will complicate matters, as the Appellate Assistant Commissioner already exercises this power after having reviewed the whole matter. Further, wide powers of re-opening assessment provided for in Section 34 amply safeguard any loss of revenue due to under-assessment.

TAXATION OF COMPANIES AND SHAREHOLDERS

Question 79

Yes.

The Committee would suggest that incomes not exceeding a particular figure, say Rs. 10,000 should be altogether exempted from the levy of the Corporation Tax and that an element of progression should be introduced up to a total income of Rs. 50,000.

Question 80

(i) Small Industries—

At present a rebate of 0-3-0 in the rupee on the total income is allowed to a public company with a total income not exceeding Rs. 25,000, only if it deducts super-tax from dividends payable to a shareholder who is believed to be not a resident in the taxable territories. The Committee would suggest that, subject to such exemptions as may be made in accordance with the recommendation made in answer to question 79 and apart from any measures that may be taken for the deduction of super-tax from dividends in accordance with the provisions of sub-sections 3(D) or 3(E) of Section 18 of the Income-tax Act, the Corporation tax on all Companies, whether private or public, engaged in manufacturing activities, with a total income not exceeding Rs. 50,000 should be fixed at a rate lower than that fixed for those having an income in excess of this figure.

(ii) Cottage Industries—

The concession recommended above for small industries should also cover the case of all companies engaged in cottage industries.

(iii) Private Limited Companies or Proprietary Companies—

Subject to the answers given in reply to Question 79, the Committee do not consider that any special concession should be granted to Private Limited Companies or Proprietary Companies except to the extent that they are engaged in manufacturing activities and have total incomes not exceeding Rs. 50,000.

(iv) Holding Companies—

Subject to reply made to Question 79, no special treatment need be given to holding companies.

Question 81

The demand for the exemption of inter-corporated dividends from Corporation Tax is justified on the

ground that such dividends pay Corporation tax once in the hands of the Company distributing the same, next in the hands of the recipient shareholder Company and, thirdly, in the shape of super-tax in the hands of the individual shareholders of the latter Company.

Question 82

A. (a) Banks—

Yes.

The present situation regarding allowance for bad debts in a bank's business often tends to produce arbitrary decisions and appears to violate the well recognised canon of taxation concerning "certainty" of incidence of a tax. The making of allowance and advances represents a distinctive feature and accounts for a substantial portion of a bank's business, and may be compared to the fixed capital assets of a manufacturing concern. In the circumstances, it is only fair that, in conformity with the practice followed in respect of depreciation of fixed assets, bad debts should be allowed in determining a bank's net profits, subject to adjustments later on in the event of future realisation.

The Committee would prefer this allowance being granted according to a fixed schedule. For, if the allowances were to be determined by the Income-tax officer in each case, on an examination of the necessary accounts, it would involve an intriguing process attended with embarrassing results. Section 10(2)(XI) of the Income-tax Act should be amended accordingly.

B. Insurance Companies—

Yes.

(a) The present system of surplus basis of assessment of Insurance Companies is inequitable and unjustifiable and calls for a change. At present only 80 per cent. of the surplus paid to, or reserved for, or spent on behalf of, policy holders is exempted from taxation. The Committee are, however, of opinion that the policy holders' surplus should be entirely tax-free as in the U. K. In justification of this suggestion, they would point out that in calculating the premiums, a conservative actuary assumes a mortality more adverse than what is expected to be experienced by the policy holders as also a rate of interest lower than what is expected to be realised on the mean life insurance fund. This is done deliberately with a view to provide margins on both these items and thus strengthen the financial position of the Company. Any benefit to the policy holders from such extra mortality and interest loadings should not, therefore, be subject to tax. It is primarily because of these considerations that policy holders' surplus is wholly exempted from taxation in the U. K. and it seems desirable that this just principle in the matter of assessment of all life insurance companies should be recognised in India also.

(b) In respect of assessment of life insurance companies, there should be no discrimination between Mutual Companies and Proprietary concerns. In the case of the former, 100 per cent. surplus goes to the policy holders and, in the case of the latter 92½ per cent. The remaining 7½ per cent., meant for shareholders, being taxed in the usual way, the quantum left for policy holders in the case of both types of Companies should be treated in the same way.

Question 83

A. The existing provisions regarding the differentiation of distributed and undistributed profits of Companies for tax purposes is not entirely satisfactory. It is true that undistributed profits are at present taxed at a lower rate, but the Committee feel that, subject to the qualification mentioned below, undistributed profits should be entirely exempted from the liability to pay tax. Capital formation has in recent years been very much retarded on account of the high rates of income-tax on higher incomes as well as of the Corporation tax. Industrial Companies are, as a matter of fact, finding it extremely difficult to find new capital either for expansion or for rehabilitation of their machinery and, if the entire portion of the undistributed profits were exempted from taxation on condition that the amount so undistributed should be ploughed back to the industry and used for expansion or for rehabilitation of machinery, there will be an incentive on the part of the Companies to set aside a comparatively small amount for distribution to shareholders and utilise the balance for expansion. The Committee hope that, in the interest of the industrial development of the country, the Commission will kindly consider the question of exempting the undistributed portion of the profit entirely from the scope of taxation.

B. For obvious reasons, the Committee are of opinion that the concession should be extended to all industrial concerns and should not be restricted to particular industries.

C. (a) To safeguard against the misuse of the concession regarding undistributed profits, particularly by Private Limited Companies to its shareholders, the

Committee would suggest that adequate provisions should be made limiting advances or temporary loans to shareholders, Directors or other persons only to those cases where it can be definitely established that such advances are in the interest of the Company itself. A further provision should be made requiring a three-fourths' majority of the shareholders to any proposal for such loan or advance.

(b) To ensure that profits are actually applied for production purposes, the auditors of the Companies may be required to furnish necessary certificates which should be incorporated in the Balance Sheets of the Companies for the year following the accounting period.

D. The provisions of Section 23-A of the Income-tax Act are not very satisfactory for reasons stated below :—

(i) The provisions of the Section are applicable to "assessable income" of the Company of the previous year, as reduced by the amount of the income-tax and super-tax, payable by the Company in respect thereof. There is, however, no provision for reducing the "assessable income" by the amount of any tax levied by the Government of a State or by the local authorities.

The Committee are of opinion that the "assessable income" should be determined only after all taxes payable by the Company either to the Central Government or to the Government of a State or to any local body, whether or not such tax is wholly or partly an admissible deduction under Section 9 or Section 10 of the Act, are deducted from the said "assessable income".

(ii) Even after deductions are made in accordance with the suggestion made above, the assessee Company may be in difficulty because of the inclusion therein of a notional income not represented by corresponding cash receipts.

In such cases, the Company is placed in disadvantageous position in paying the tax on income which has not been actually received by it in cash.

(iii) A further difficulty arises because of the practice of Income-tax Officers in assessing profit after adding back payments like charity, capital expenditure, etc. and after disallowing certain amounts that may have been written off as bad debts. The experience which the assessee have of the manner in which assessments are made by the Income-tax officers justifies their apprehensions about the great disparity between the actual income of a Company and the "assessable income" as computed by the officers.

The Committee would, in this connection, draw attention to the observations made by the Income-tax Investigation Commission in paragraph 92 of their Report admitting that the difference of opinion or in the method of calculation between the assessing officer and the Companies' officers may be perfectly "honest", and suggesting a number of relaxations, which should receive careful consideration from the Taxation Enquiry Commission.

The Commissioner had suggested that as, by reason of an honest difference of opinion or in the method of calculation between the assessing officer and a company, the amount distributed may prove to be less than 55 per cent., insisted on by the second proviso to the Section, as a condition precedent for giving a *locus penitentie* to the company for escaping a penal order under this section, the proviso should be enlarged so as to include cases where the distribution actually made has fallen short of 60 per cent. of the assessable income by reason of the assessing officer determining the assessable income to be greater than it was according to the calculations made by the company. The Commission also recognised that, even after this relaxation, some cases might present special features. They pointed out that, though Section 23-A authorises the Income-tax Officer to make an order under sub-section (1) only "with the previous approval of the Inspecting Assistant Commissioner", it is possible to contend that all that the Inspecting Assistant Commissioner can consider, when asked to approve of a proposed order by the Income-tax Officer, is whether the conditions prescribed in the sub-section have been satisfied, and not exercise a discretion *de hors* the Section. They, therefore, suggested that, in addition to the provision made in sub-section (2) requiring the Inspecting Assistant Commissioner not to give approval to the Income-tax Officer's proposed order until he has given the company an opportunity of being heard, there should be a further provision to the effect that the Inspecting Assistant Commissioner may, for reasons recorded by him in writing, withhold his approval even when he finds an agreement with the Income-tax Officer that the conditions prescribed by the opening words of sub-section (1) exist.

(iv) As regards the concession made in the second proviso to clause (1) of the Section regarding a further declaration of dividend to cover the deficiency over 55 per cent. of the dividend, the Committee would suggest that the concession should be allowed where a dividend of at least 50 per cent. has been declared.

(v) The Committee would further suggest that the first proviso to Clause (1) of the Section should be deleted in order that a Company may build up a reserve with a view to secure a sound financial footing.

(vi) The Committee are also of opinion that, where the Tax is recoverable from a Company under Section 23(A) (3), the amount of liability may be reduced by the amount of the tax for which no credit is given in the assessment of the shareholders. In other words, where total effect has not been given of the application of Section 23(A) in the assessment of all the shareholders but it has been considered in the case of few shareholders only, by whom the tax is payable, then the amount representing the tax borne by the Company which has not been considered in the assessment of such shareholders should be deducted from the amount of the tax payable by the Company.

Question 84

No.

The Committee consider it reasonable to afford some relief to the shareholders from payment of Super-tax in respect of income received as dividend which has been already subjected to Corporation Tax in the hands of a payer Company. As shareholders are quasi-proprietors of a company and as net dividend is paid to them only after the tax is paid by the Company, it is not fair to levy the same nature of tax once in the hands of the Company and again in the hands of the recipient shareholders. It is, therefore, suggested that the treatment accorded to the levy of Super-tax in the hands of a shareholder should be the same as to Income-tax paid by them. In other words, the Corporation Tax suffered by the amount of dividend should be taken into account in levying Super-tax from shareholders from such dividend, the credit being given at the average rate of Super-tax chargeable or at the rate at which the dividend has suffered Corporation tax, whichever is lower.

Question 85

Yes.

The principle has been accepted universally that industrial, commercial and similar other enterprises undertaken by the Government and local bodies should be run on sound commercial lines and even, in those cases where there is no competition between private and public enterprises, the latter should be required to contribute from their earnings to general revenues an amount that would be payable by way of income-tax as if they were private concerns.

EVASION AND AVOIDANCE OF TAX

Question 86

A. The Committee agree that the services of Chartered Accountants should be utilised to a larger extent than at present for assisting in the determination of the taxable income of assessees. The form of the certificate laid down by the Indian Companies Act may be suitable from the point of view of the shareholders but may not quite serve the purpose of determining the taxable income. The Committee would, therefore, suggest that a form of certificate about the correctness of the computation of income shown in the return under the provisions of the Income-Tax Act may be laid down for the purpose.

B. A Chartered Accountant issuing a certificate referred to above will necessarily have to assume responsibility for the correctness of the Statement made therein.

C. The Committee agree that the certificate of a Chartered Accountant on the lines stated above should invariably accompany the return for business income over a certain limit and that the form of the certificate that may be prescribed for the purpose should indicate the scope of the check exercised by the Chartered Accountant.

D. The suggestions made above are subject to the fundamental condition that all such certificates should be accepted by the Income-tax Officers and that the assessee will be spared unnecessary harassment.

E. The Committee agree that fees payable by the Assessee to the Chartered Accountants for the certificates referred to above should be restricted to a schedule prescribed by the Government, unless otherwise agreed to between the parties themselves.

Question 87

The Committee have no suggestion to make.

Question 88

The Committee do not consider that the publication of the names of the persons who are penalised for con-

cealment of income will serve any useful purpose. They would, however, suggest that, subject to the right of the persons penalised having the right of appeal against the penalty to the High Court, they may be disqualified to hold positions of trust or membership of legislative or local bodies for convictions under Section 52 of the Income-tax Act.

Question 89

The Committee do not consider that the present practice of excluding from taxable profits perquisites given to employees of business undertakings results in a considerable loss of revenue. These perquisites are in the form of (a) house-rent allowance, (b) refreshments and tiffins, (c) entertainment allowance, (d) travelling allowance, and (e) conveying allowance, etc.

The Committee are of opinion that, except in the case of (a) where 10 per cent. of the salary may be included in the total income, no notice should be taken of other allowances. In any case, the principle which should be followed in this respect is that the perquisites should be allowed to the extent to which such expenses are reasonable, provided the amount disallowed, if any, is assessed in the hands of the recipient and is allowed as expenditure in the hands of employer. If necessary, a maximum limit of the amount to be so allowed may be fixed.

Question 90

Payment of taxes in the case of a Company under liquidation should have a prior charge.

Question 91

A. Already very large powers are conferred on Income-tax authorities and the Committee strongly oppose the conferment of larger powers.

B. The Committee are strongly opposed to any power being given to the Income-tax authorities to search premises and seize documents and books of accounts. Any power that may be given to the Income-tax Officers or their superior Officers to enter the building or the place of an assessee smacks of more than police powers, and is bound to undermine the credit and prestige of the assessee and harm their business interests. As for books, even now assessee are bound to produce them whenever called upon to do so by the Income-tax Officers, and it is not understood what further power is suggested to be given to the Officers. The Committee are in any case strongly opposed to a suggestion which was made in 1951 to give power to the Income-tax authorities to impound and retain in their custody books of account of any assessee.

Question 92

The Committee are against any penalty rates being imposed to minimise the avoidance of a higher rate resorted to by an assessee, keeping in conformity with the provisions of the Income-Tax Act. No step should be taken against any legal avoidance of taxes.

RECOVERY

Question 93

The recovery of outstanding tax of any partner of a registered firm should be made from the firm itself. In case, however, it is not possible to do so, such recovery should be made from the partners limited to the extent of their drawings.

Question 94

The present arrangements relating to recovery of Income-tax are, in the opinion of the Committee, adequate. They would, however, suggest that the Income-tax Department should have a Departmental machinery for enforcing the recovery of arrears of tax. It will avoid a lot of troubles and inconveniences if the machinery is run by the Department, and the recovery is not enforced through the Certificate Department, as at present.

Question 95

In the case of a Private Limited Company, there are shareholders who do not take active part in the management and any liability for the payment of the tax should, therefore, be imposed only on the Directors.

This suggestion is, however, subject to the observation made below.

There are bound to be hardships in collecting tax from a Private Limited Company in a year when due to losses incurred there may not be cash to pay the tax on profits of the previous year.

Question 96

Recovery proceedings should be instituted only after the judgment of the Tribunal.

GENERAL**Question 97**

(i) The Income-tax Department should have a separate Section to provide free advice to small assesseees on the points mentioned in the question.

(ii) Appointment of a Public Relations Officer may be helpful for providing information on various matters relating to assessment proceedings.

(iii) Income-tax Officers should appreciate that the time of the assesseees is valuable and they should try to expedite their cases as early as possible.

(iv) The Income-tax Officer should inform the assesseees beforehand of all the points that he would require for the purpose of assessment to his satisfaction. This procedure will bring all facts and relative documentary evidence in the surface.

Question 98

(i) All notice should be issued by Registered Post with Acknowledgement Due.

(ii) Different forms may be prescribed for different classes of assesseees, particularly the salaried personnel and owners of house property, the assesseees being required to declare that they have no other income.

(iii) Present arrangements should be continued except that the Income-tax Officers should not be authorised to impose penalty.

(iv) As regards recovery of tax, please refer to the replies in answer to Question 94.

(v) The position of Appellate Assistant Commissioners is rather anomalous at present. Even though they are appointed by the Central Government, they are under the administrative control and jurisdiction of the Commissioners and the Central Board of Revenue. The Commercial Community have all along urged that the Appellate Assistant Commissioners should, in view of the special functions they perform, be placed under the Ministry of Law. But this proposal has not so far been agreed to by the Government. The proviso to Section 5(8), which provides that the Central Board of Revenue shall not issue any orders, instructions or directions to the Appellate Assistant Commissioners so as to interfere with their discretion in the exercise of their appellate powers, does not, in actual practice, ensure the independence of the latter. The fact remains that, being under the administrative control of the Commissioners, and subject to the orders of the latter in respect of their leave, transfer, postings and promotions, they are not always in a position to take an independent line in the exercise of their appellate functions.

Reference may, in this connection, be made to the Recommendation (No. 149) of the Investigation Commission that the Appellate Assistant Commissioners should be removed from the control of the Commissioners and the Central Board of Revenue, and should be placed under the Appellate Tribunal and further that their leave, transfer and postings should be in the hands of the Tribunal.

The Commission also examined the suggestion that the Appellate Assistant Commissioners should be recruited from among the senior subordinate judges and, while they drew attention to the fact that the nature of the work requires an intimate knowledge of income-tax work which a purely judicial officer is not ordinarily expected to acquire even after a brief period of special training, they did not throw out the suggestion entirely and had, in fact, suggested that an experiment should be tried in a few instances, if there was no other difficulty in the way of doing so.

The Commission further suggested (Recommendation No. 150) that the normal avenue of promotion for Appellate Assistant Commissioners should be the Appellate Tribunal and further that, if it were not possible to afford reasonable prospects of promotion to all the Appellate Assistant Commissioners, a few posts in the grade of Appellate Assistant Commissioners carrying a salary approximating to that of Commissioners of Income-tax should be created. The idea which the Commission had evidently in view was to make the Appellate Assistant Commissioners completely free from any administrative control and functional interference of the Department. Unfortunately, this recommendation has not been accepted by the Government.

On their part, the Committee fully endorse the views of the Commission and would recommend that the Appellate Assistant Commissioners should be appointed by

the Ministry of Law and should be under the administrative control and jurisdiction of the latter.

It is further necessary that their designation should be such as not to imply their subordination to the Commissioners. The Committee would suggest, for consideration by the Government, the designation of "Appellate Commissioners" being conferred on them.

Question 99

(a) Yes.

The delay is due partly to the dilatoriness on the part of the officers.

(b) The Committee would suggest that a system of rebate granted in case of prompt payment of the tax would lead to speedy collection of a substantial portion of the tax.

SPECIAL BUSINESS TAX**Question 100**

The Committee do not consider that, having regard to the existing circumstances of Indian economy, the imposition of excess profit tax or special business taxes would be justified.

DEATH DUTY**Question 101**

The Estate Duty Bill has now been passed into a law, and though the provisions of the Act are in some respects better than those originally proposed by the Government, the Committee believe that the present time was not opportune for imposing a tax on estates passing on the death of a person. They would, however, prefer not to make any observation at present on the matter and would like to watch the effects thereof on the economy of the country.

Question 102

Yes.

PART III.—COMMODITY TAXES (CENTRAL AND STATE).**CUSTOMS****IMPORT DUTIES****Question 103**

(i) and (ii) In the first schedule to the Indian Customs Tariff, namely Import Tariffs, commodities have been grouped into 22 broad sections and goods coming under each section have again been classified under various items, the total number of broad items being only 87. On the other hand, in the Import Trade Control Schedule, goods have been classified under about 600 items in six parts for the purpose of licensing of imports. While the grouping under Import Control Schedule cannot by any means be said to be logical and rational and is undoubtedly open to revision, the Committee believe that the said Schedule in detail is more scientific, having been governed by the two-fold consideration of availability or otherwise within the country of the commodities and their end-use. On the other hand, the Indian Customs Tariff Schedule was originally prepared at a time when industrial development in the country had not progressed on such a large scale as at present, and periodical additions or alterations which have since been made mostly on *ad hoc* basis have not been of general help. Naturally the Tariff has not been as scientific or elaborate as should be and this has led to confusion in the matter of classification and assessment of duties.

The Committee feel that the Import Tariff needs general overhauling to suit modern-day conditions of trade and the progressive industrialisation of the country, due account being taken at the same time of the end-use of the goods concerned either as raw materials or as finished goods.

The latest International document about Customs Tariffs is the Tariff Nomenclature prepared for Customs Purposes by the European Customs Union Study Group (*vide* Standard International Trade Classification—United Nations Statistical Office Statistical Papers series M. No. 10—second edition—New York, June 1951). While the 22 sections in the Indian Tariff are undoubtedly based on accepted international standard, there is a considerable divergence in matter of details under each section. It is true that all the details in the latest International document may not be suited to or required for Indian conditions, but a close study of this document, having due regard to our peculiar circumstances, may be of assistance in bringing the Indian Tariff to a more stable and scientific basis.

For their part, the Committee would like to make a few suggestions about the re-grouping and re-classification of certain commodities as follows:—

Item.	Present ICT No.	Proposed ICT No.	Remarks.
Coloured and Copying Pencils.	45(4)	30(7).—Lead Pencils'	Copying and coloured pencils are as much pencils as lead pencils and there is no reason why these items should be included in a classification other than that of lead pencils. It is, therefore, suggested that coloured and copying pencils should be grouped together with lead pencils under a broad heading 'Pencils' falling under the existing I.C.T. Items No. 30(7). It need hardly be stressed that, in revising the tariff classification of the articles, the prevailing differential rate of customs duties, which are protective, should be retained.
Pencil Lead (Pencil slip)	45(a).—Stationery N.O.S.	30(7).—Lead Pencils	Pencil lead or pencil slip is a major manufactured part of "lead pencils". The item should, therefore, be classed with or without a separate heading under the general item "lead pencils" and should be charged the same rate of duty as the latter goods.
Gold or Gold plated nibs and clips.	61(7)	45(a).—Stationery N.O.S.	The revision in the existing customs classification of gold or gold plated nibs & clips is warranted by the fact that they constitute essential accessories of fountain pens and the lower rate of duty applicable to stationery N.O.S., should be extended in their case.
Pins Stapling Machine	71.—Hardware, Iron-mangery & tools, all sorts, N.O.S.	45(a)	These are the items which are exclusively dealt in by stationers and should, therefore, be covered under the sub-heading 'Stationery all sorts N.O.S.' and the rate of duty applicable to the latter category of goods should be extended in these cases.
Ferro-Prussiate and other sensitised paper.	77(5).—Photographic, instruments, apparatus & appliances.	45(a)	
Paper Perforating Machines.	77.—Instruments, apparatus and appliances other than electrical, all sorts, N.O.S.	45(a)	
Patchouly leaves, Rose Flowers, dried Ambergrics, Absolutes, Concretes, etc.	31(5).—Perfumery not otherwise specified.	Should be classified under a separate item.	These materials are not perfumery as such, but industrial raw materials for the perfumery industry.
Methyl Propyl and Iso-Propyl Alcohol.	22(4).—Spirits other than Denatured Spirits.	28.—Chemicals	These alcohols are non-edible spirits required generally for industrial purpose and should, therefore, be classified as chemicals.
Paper for Sensitising Stereo, Litho, etc.	44	Separate classification is suggested.	These are essential raw materials for certain local industries and as such should be classified separately from writing and printing paper.
Casein	87.—All other articles not otherwise specified.	Should be included as a special item.	Assessment of Casein under item No. 87 might have been justified at a time when imports were on a very small scale. But now that Casein is being imported on a large scale for use by the well-developed local Plywood industry, it is desirable that Casein, the raw material for the Plywood industry, should be separately classified.
Aeromatic Chemicals	28.—Chemicals, Drugs & Medicines N.C.S.	Should be separately classified.	Aromatic Chemicals which are raw materials for some indigenous industries are imported into the country in large quantities, and should, therefore, be separately classified.
Synthetic Essential Oil	31(3)	Should be classified with item No. 31(5).—Perfumery not otherwise specified.	With a few exceptions, the products classified under "synthetic essential oils" are perfumery compounds and should, therefore, be brought under item No. 31(5) 'Perfumery not otherwise specified'.

The Committee would further draw attention to the fact that the item 87 in section XXII of the Tariff embraces a wide range of articles from raw materials for industries, gases, chemicals, etc., to finished products. Such a position is hardly defensible and a greater clarity and classification of goods sectionwise is desirable.

(iii) The revision and re-classification of the I.T.C. Schedule had recently formed the subject of an enquiry by Sri P. M. Mukherji, formerly Director General of Commercial Intelligence and Statistics, who was appointed by the Government of India as an Officer on Special Duty for the purpose from July 1952 to March 1953. In the course of his examination of the problem, Sri Mukherji had prepared and circulated drafts of a revised Import Trade Control Schedule in the light of the suggestions received from various Chambers of Commerce and Trade Associations. This draft was examined by the commercial interest, including the Chamber,

who duly submitted their comments on the proposals contained therein, and the Committee of the Chamber had also had an opportunity of holding discussions with Sri Mukherji at Calcutta. In course of discussions, Sri Mukherji had stated that, in the final scheme which he would submit to the Government, it was his intention to add, apart from a revised draft of the I.T.C. Schedule, a separate statement showing the co-relation of the items in the revised I.T.C. Schedule with the items in the Indian Customs ariff as well as a tentative draft manual giving the illustrations of articles or groups of articles which fall within, or are excluded from the scope of an item in the revised Schedule and also mentioning the items about which difficulties of classification might have been experienced in the course of the working of the Import Trade Control. Sri Mukherji's final Report has not as yet been published by Government but will probably be made available to the Commission, who will undoubtedly take into consideration the recommendations made by him. In any case, the

Committee would suggest that action should be taken to bring about, among others, a proper co-relation between the Indian Customs Tariff Schedule and the Import Trade Control Schedule and that arrangements should exist for proper revision of the co-relation statement from time to time so that the trade continues to receive adequate guidance.

The Committee would also draw attention to the need for removing the anomalies arising out of the imposition of certain conditions in respect of imported chemicals, drugs and medicines. While the Import Licensing Authorities have laid down no packing conditions for these articles, the Customs Authorities at the Calcutta Port have imposed certain restrictions in this regard leading to wrong classification and assessment of the commodities concerned, and difficulties in clearing them. Greater liaison between Import Trade Control and Customs is required in this matter.

Mention may in particular be made of the following instances :—

- (a) *Benzyl Benzoate, Sodium Benzoate, Balsam Tolu, Calcium Gluconate, Citric Acid, Sodium Salicylate, Salicylic Acid, etc.*

These items may be treated both as chemicals (I.T.C. Sl. Nos. 22, 29, 31, etc., of Part V) or as medicines (I.T.C. Sl. No. 109 of Part IV). The usual practice of the Customs is, however, to classify these as 'Chemicals' when imported in bulk and as 'medicines' when imported in small packings, and assess duty accordingly, [cf. I.C.T. items 23 to 28 (29)], though their limit of 'Small' and 'bulk' packings is seldom publicly announced. It is likely that some trade practice is being followed in these matters but it is necessary that Government should make clear the *raison d'être* behind their action and issue a public notification defining the position about packing in respect of items concerned. In the absence of clear-cut definitions and distinctions, the Customs Authorities should allow the clearance of goods concerned under licences for 'Chemicals' as well as for 'Medicines'.

(b) *Olive Oil*

This item is classified by the Customs Authorities as 'Vegetable non-essential Oils', I.T.C. Sl. No. 61, Part IV, and I.C.T. item No. 15(6), in bulk packings, and as 'medicine' I.T.C. Sl. No. 109 Part IV and I.C.T. item No. 28, when imported in small packings of not more than 1 gallon. As overseas suppliers sometimes offer Olive Oil in packing of 1 gallon or less either because Olive Oil in packing of more than 1 gallon is not in their stock, or because Olive Oil imported in small packing may be had for immediate delivery, it is suggested that Olive Oil should be classified by the Customs under one heading, viz., 'Vegetable Non-essential Oil'.

(c) *Adeps Lanae B.P.*

Adeps Lanae B. P. is classified as medicine under I.T.C. Sl. No. 109, Part IV, while the Customs classify the article when in packing of more than 1 lb., under "all sorts of animal fat, not otherwise specified", I.C.T. item No. 15, and subject it to a duty of 31½ per cent. *ad valorem*, as against a duty of 27·3 per cent. on medicines, I.C.T. item No. 28. There is no justification for classifying *Adeps Lanae* packed in bulk separately and assessing the same to the higher rate of duty. If, however, any differentiation is at all to be made, *Adeps Lanae B. P.* in whatever packing should be classified as drugs and medicines under I.C.T. No. 28, and *Adeps Lanae* of commercial quality in whatever packing should be classified as 'all sorts of animal fats not otherwise specified' under I.C.T. item No. 15.

The aforesaid suggestions, among others were submitted to Sri P. M. Mukherji who was examining the matter of revision of the I.T.C. Schedule and it is hoped the Commission will also give sympathetic consideration to them.

(iv) There are a number of items in the I.T.C. Schedule and the I.C.T. Schedule which are not clearly defined. Mention may, in particular, be made of Essential Oils, both Natural and Synthetic, and Aromatic chemicals. As a result, these items are frequently wrongly classified by the Customs leading to difficulties in the matter of the clearance of the goods from the Port and correct assessment to duty on the same.

The Committee would therefore suggest that these items should be clearly defined as under:—

- (i) *Natural Essential Oil* : I.T.C. Sl. Nos. 127-129, Pt. IV & I.C.T. Item Nos. 31, 31 (1) and 31 (2).

Natural Essential Oils are steam volatile substance obtained from odorous parts of natural plants, flowers, herbs, roots, balsams, gums, fruits etc., without addition of any chemical or synthetic oils.

- (ii) *Synthetic Essential Oils* : I.T.C. Sl. No. 130, Part IV and I.C.T. Item No. 31(3).

Synthetic Essential Oils are mixture of various chemicals, mainly odorous, with or without

the addition of Natural Essential Oils, blended together judiciously to give a suitable perfume for use in the preparation of toilet products. These may be liquid or viscous.

- (iii) *Aromatic Chemicals* : Classified under I.T.C. Sl. No. 12, Pt. V & I.C.T. Item No. 28.

Aromatic Chemicals are pure chemicals, liquid or solid, having a definite formula and composition mostly with an aroma and mainly used as components of synthetic essential oils, perfumes and in the preparation of toilet products. Also used in medicines, viz., Benzyl, Benzonate, Menthol, Methyl Salicylate, etc.

(iv) *Resinoids.*

This is now classified as 'Perfumery not otherwise specified' under I.T.C. Serial No. 132 of Part IV & I.C.T. Item No. 31(5). As, however, "Resinoids" is not strictly an item of perfumery but is a perfumery raw material, it should be classified under a separate heading.

(v) *Laboratory Chemicals.*

At present this item is classified under 'Chemicals not otherwise specified' (I.T.C. Sl. No. 12 Part V). There is, however, no clear-cut definition of the said term, resulting in difficulties to the importers. An attempt has been made under the I.T.C. regulations to throw some light inasmuch as it has been laid down that imports of what categories of goods will not be valid under licences issued for laboratory and reagent chemicals. This is not, however, adequate, and it is suggested that both for Customs and Import Trade Control purposes, the term 'Laboratory Chemicals' should be clearly defined and it should also cover items like Pulv Rhei, Albumen from Eggs, Santonin, etc., which may be required in laboratories for research and experimental purposes, but are nonetheless classified by the Customs as medicines.

- (vi) As the definition of 'Natural Essential Oils' as given above, does not cover three other classes of important perfumery raw materials, viz.,

- (a) Balsams and aromatic gums,
(b) Resinoids and Resinogums, and
(c) Concretes and Absolutes,

the definitions for these products should be as under:—

- (a) *Balsams and Aromatic Gums*.—These products are aromatic exudations obtained from certain trees.
(b) *Resinoids and Resinogums*.—Products obtained from various parts of plants excluding flowers by means of solvents—Benzene Toluence, Petroleum, Ether, Alcohol.

Question 104

(i) While generally rates of import duties should be fixed for different groups or sub-groups of commodities mainly with the object of earning revenue, the following considerations should also be taken into account in fixing the rates:—

- (a) In regard to those industries which are protected, the rates should admittedly be those which are recommended by the Tariff Commission.
(b) The rates of duties on raw materials, stores, plants and machinery which are not available within the country should be fixed as low as possible in order to enable the consuming industries to compete with types of imported goods manufactured by those industries.
(c) The indigenous industries, which have to compete with foreign rivals in export markets in respect of their finished products, should be refunded the entire amount of duty paid by them on imported raw materials, subject to satisfactory safeguards in the application of the formula.
(d) The rates of duties on essential articles of consumption, particularly those used by poorer sections of the community, should be fixed at as low a level as possible, consistent with the revenue requirements of the Government.

- (e) In regard to the rates of duties on any commodity, whether finished or raw materials, the Government should necessarily examine the incidence of these duties and whether the rates are high resulting in diminishing returns.

(ii) **A. Raw Materials**

The attention of the Committee has been drawn to the cases of the following raw materials, the high rates of duties on which bear heavily on the industries in which they are processed:—

- (a) Casein, (b) Soda Ash, (c) Borax, (d) Alloy Steel, (e) Carbon (black), (f) Fatty Acid and Heavy Fatty Acid, (g) Gas-filled Cylinders, (h) Methyl and Ice Propyl Alcohols, (i) Raw Materials for perfumery industry, (j) Beechwood for Card Staves, (k) Coconut Oil, (l) Natural Essential Oils, (m) Vitamins, (n) Raw materials for the Refrigerator Industry and (o) Gold or Gold-plated Nibs and Clips.

There is strong case for the reduction in the rates of duties on all these items.

References to the last three items mentioned above are being made in reply to Question 104(iv), and a short explanatory note on the other items is appended as Annexure I.

In addition, the question of adjusting the duties on the items mentioned in reply to Q. 103 as a result of their re-classification should also receive careful consideration.

B. Finished Goods

There can be no doubt that the existing rates of customs duties on the import of some of the finished goods bear heavily on the consumers. The rates have been increased from time to time by the Government to cover their revenue needs and a full examination could not naturally be made of the probable effects thereof on the consumers. On the other hand, the increase in some of these duties at least has had the effect of giving an indirect protection to the indigenous industries manufacturing the goods concerned and the question as to whether and, if so, to what extent these duties should be reduced has to be considered very carefully. The case of paper and paper products has, in this connection, been brought to the attention of the Committee. It has been stated that paper being an article of common use and required, *inter alia* for educational purposes, the import duty thereon should be as low as possible. At the same time in considering any such reduction in import duty its effect on the Paper Manufacturing Industry in this country will have to be taken into account.

There may be many other commodities in respect of which similar observations may be made.

- (iii) The Committee received complaints about smuggling of goods from foreign countries, particularly from Pakistan, mainly with the object of evading payment of high rates of import duties. But, in their opinion, the question is one of administrative arrangements rather than of reduction of duty in respect of any specific commodity. Moreover, any reduced duty will have to be of general application and under India's international obligations cannot be applied to goods of Pakistani origin only.

- (iv) The following cases of higher import duties on the constituent parts than on finished products have been reported to the Chamber:—

(a) **Resinoids—**

While the duty on resinoids, which is classed as "Perfumery", I.C.T. item No. 31(5), is assessed at 66½ per cent. *ad valorem*, that on some of the finished products, in which Resinoids are used as ingredients, are assessed at 37½ per cent. under I.C.T. item No. 28(14).

(b) **Vitamins—**

Vitamin preparations are assessed to a duty of 20 per cent. *ad valorem* under I.C.T. item No. 28(29), but the duty on Vitamine is assessed at a higher rate under I.C.T. item Nos. 28 & 28(21).

(c) **Raw Materials for Refrigerator Industry—**

The Refrigerator Industry has to pay duties ranging from 30 to 36 per cent. *ad valorem* on its imported raw materials such as, refrigerant gas, copper tubes, paints for finisheg, etc., even though the import duty on a completed refrigerator is only 24 per cent. *ad valorem*. As a result, the competitive position of the indigenous refrigerator industry *vis-a-vis* the foreign industry is greatly weakened.

(d) **Gold or Gold-plated Nibs and Clips**

The indigenous Fountain Pen Industry has been experiencing great difficulties on account of the heavy duties on imported essential accessories, *viz.*,

Gold or Gold-plated Nibs and Clips. At present, these items are being assessed to a duty of 66½ per cent. *ad valorem* even though Fountain pens complete are subjected to a duty of only 30 per cent. *ad valorem*.

With a view to give relief to the indigenous industries mentioned above, it is necessary that a parity should be maintained between the import duties on the essential raw materials and those on the finished goods in which they are used.

- (v) The Committee believe that there may be cases where owing to high rates of duties the yield has reached the point of diminishing returns but, in the absence of necessary statistics, it is not possible for any non-official organisation like the Chamber to make any categorical statement on this point. The Commission may, however, be able to secure necessary information in this regard from the Government of India themselves. Even the latter will not possibly be able to arrive at a definite finding in the absence of any reliable record of the course of trade over a series of normal years. The abnormal years of the war have been followed by a period of great foreign exchange difficulties necessitating imposition of great restrictions on imports, and it is difficult to isolate the incidence of the duties on the volume of the trade.

It has, however, been brought to the notice of the Committee that in some cases import licences granted by Import Trade Control have not been utilized or only partially utilized because of the apprehension of the importers about the inability of the market to absorb the imported goods concerned at current market prices. It is possible that, in several of these cases, details of which may be had from the Import Trade Control authorities, the comparatively high prices of the imported goods were accounted for by the prevailing high rates of customs duties.

Question 105

As already stated in the preliminary Memorandum of the Chamber, in a period of rising prices, *ad valorem* duties lead to correspondingly high prices of the imported goods, the increase over the c.i.f. prices being similarly smaller in a regime of falling prices. Apart from the purely budgetary considerations, *ad valorem* duties have definitely a tendency towards accentuating the inflationary effects in period of rising prices and, subject to their suitability in a scheme for Tariff Protection, may also retard capital formation by reducing the margin of saving and the amount available for investment. A specific duty, on the other hand, does not influence the cost of imported goods to the same extent and may be welcomed by the consumers in a period of rising prices.

Considering all the aspects of the matter, it is desirable that specific duty should preferably be replaced by *ad valorem* duties for two reasons:—

Firstly, in the Indian Customs Tariff only some items are subjected to specific duty and in the majority of even such cases, provision has been made for assessment of *ad valorem* duty in the alternative, if it is higher than the specific duty.

Secondly, specific duties, if they are to be fair, should involve differentiation of different grades of the commodities which is not always possible.

It is true that, in the case of specific duties, the scope for friction between the importers and the assessing staff on the question of the adequacy of the declared price is much smaller; but if, as has subsequently been suggested in answer to question No. 106, the invoice values of the goods imported are accepted by the Customs, there should not be any difficulty in the application of the *ad valorem* duties.

Question 106

(i), (ii) and (iii). From complaints which have been received by the Chamber, it appears that tariff values are not generally satisfactory basis for assessment of import duties. The tariff values are determined by the Government on the basis of the ex-duty average wholesale monthly market prices at the main importing centres in India during the 12 months ending June, each weighed by the relative importance of the trade in each particular article at each of the principal importing centres, and modified when necessary in the light of proposals made by the various Collectors of Customs and Central Excise authorities in India and also having regard to the probable future trend in prices. The tariff values at the provisional stage are of course discussed with the representatives of important commercial bodies before being finalised, but the values have usually been fixed by the Government at a higher level than what is considered fair and just by the trade. The differences of opinion between the Commercial Bodies and the Government on the question of fixation of tariff values arise out of the fact that the former do not always agree on the basis of the information available

with them, with the basic data and other subjective considerations on the basis of which the Government fix the tariff values.

The Committee do not deny that the incidence of tariff values is like that of specific duties and that if a greater measure of co-ordination and liaison could be established between Government and the trade in the matter of fixation of these values, the existing system might be maintained in respect of a few specified commodities, determined beforehand in consultation with the trade.

As, however, these conditions may not always be easily satisfied, and to avoid these complications, the Committee would suggest that, as in the majority of the cases of the imported goods, the value of the goods, declared in the Invoices, supported by documents, should be accepted by the Customs authorities, for the purpose of applying the *ad valorem* duty.

Question 107

(i) and (ii). The observations made in reply to Question No. 106 apply equally to this question. The assessment should normally be on the price at which goods of like kind and quality can be delivered, that is invoice price to which cost of freight may be added if not already done and, only if there is reason to suspect that the invoice is not genuine, should the duty be assessed on the wholesale cash price less trade discounts and import duties.

Question 108

The Committee are in favour of granting exemptions from or reductions in import duties in regard to all the items mentioned in the question, subject to the need for development of indigenous industries and to the adoption of due safeguards for preventing abuse of concessions.

Question 109

The Committee are in favour of bi-lateral fiscal arrangements with different countries, whether within the Commonwealth or not, provided—

in the first place, preferences given by India to the exports from particular countries actually result in a corresponding increased off-take of Indian goods in those countries, and

secondly, by such mutual trade pacts India does not antagonise other countries which might be in a position to offer larger and more abiding markets for Indian goods than within the country with which bi-lateral trade pacts are being entered into.

Question 110

Members of the Chamber have expressed different views in regard to the issues raised in this question.

There is a certain section which prefers the imposition of high customs duties to the fixation of import quotas as a means of restricting imports. The main argument which they put forward in support of their views is that the high tariff wall thus erected would adequately protect indigenous industries from unequal and sometimes unfair competition from abroad. They also seem to think that a system of import quota, without high rates of duties, permitting the import of howsoever smaller quantity of goods from foreign countries at comparatively low prices, might disturb the market structure within the country in such a way as to compel the indigenous industries to sell their products sometimes even below cost. A further point is the general objection to control as such. Though during the last few years some of the undesirable features of Import Trade Control have been gradually removed, no system can in fact be evolved which can be free from objectionable features. Besides, a system of Control cannot be a permanent feature of any economy.

On the other hand, there are those who believe that the high rates of duties are not always effective in preventing the import of goods from foreign countries, and the lurking prejudice still unfortunately existing amongst consumers in India against Indian goods sometimes makes it possible for imported goods to be sold in the market even at higher prices. The fixation of an import quota would, however, restrict the total quantity of imported goods thus available for consumption by consumers having preference for the same. As a matter of fact, the Government of India have also accepted the policy of quantitative restrictions of imports for giving protection to the indigenous industries concerned, apart from any consideration to the need for conservation of foreign exchange of the country.

The Committee consider that these views can be harmonised, and the application of one or other will depend largely on the circumstances of each case, having regard to the nature of goods, their vulnerability to competition and their popularity, etc.

Question 111

The Committee feel that full facilities should be afforded to indigenous industries using imported materials and exporting finished products abroad to obtain refund or draw back of duty paid on those materials. While they do not deny the need for taking adequate steps to safeguard the revenue interests of the Government, they are at the same time of opinion that the industries concerned should not be required to fulfil any harassing procedure, so as to nullify the benefit of concessions granted.

Question 112

For settlement of disputes arising out of appraisal, Arbitration Boards should be formed at each Port with, among others, the representatives of the Chambers of Commerce and Trade Associations concerned.

Further, the procedure relating to appeals against penalties imposed under the Sea and Land Customs Acts, should be analogous to that under the Indian Income-tax.

According to Section 40 of the Sea Customs Act, no refund of charge erroneously levied or paid is made unless the claim is made within 3 months from the date of payment. This time limit is too short to enable the importers to contact their overseas suppliers, which is so often necessary, and to make their papers ready for the purpose of filing the claim. In view of this and also in view of the fact that there is no time bar for the Government in making any claim on parties, the Committee would suggest that at least 6 months' time, as in the case of claims against the Railways for refunds of dues, should be allowed to the assessee for filing their Customs claims.

EXPORT DUTIES

Question 113

The main considerations which should govern the imposition of export duties are as follows:—

- whether the particular trade or industry can bear the burden in meeting competition in foreign countries from other alternative sources,
- whether it is desirable or necessary to discourage the export of particular articles to foreign countries having regard to the need for conserving the supplies within the country,
- whether the commodity, subjected to duty, is a monopoly product of the country or whether this country is the major supplier of the articles,
- whether the exportable item is a raw material for the industries of other countries which are carrying on keen competition with the local industries in the foreign markets.

Where the conditions (c) and (d) are both satisfied, there may be a strong case for imposition of export duty both for earning revenue and to give protection to the indigenous industries—concerned. A short note on the incidence of the export duties on various articles in the light of the above considerations is appended as Annexure II.

Question 114

When the Indian Tariff Act, 1934, was first enacted, export duties were enforced only on four commodities. Since then, considerable additions have been made to the list and modifications made in respect of the rates of duties. The list now includes as many as 16 items.

Some of these duties were imposed by Amendments of the Indian Tariff Act, 1934, while in respect of a few others resort has been taken to the powers conferred upon the Government to levy or increase export duties by Section 4A inserted into the Indian Tariff Act by an amendment in December, 1950. While this amend Act provided that any Notification issued thereunder would cease to have effect on the 1st March 1952, a subsequent amendment made in July 1952 has removed this time-limit and any Notification, made under Section 4A which may be approved by Parliament, may now be rescinded by the Central Government at any time by Notification in the Official Gazette. Reference may, in this connection, be also made to Section 23 of the Sea Customs Act, 1878, which empowers the Central Government to exempt, by Notification in the Official Gazette, any goods, imported into or exported from India or into or from any specific part therein, from the whole or any part of the Customs duties leviable on such goods.

It is, therefore, clear that, subject to the subsequent approval by Parliament of any action taken by the Government in imposing a new export duty or increasing the rate of duty, the Government have undisputed right to impose, increase or abolish export duties on any particular commodity. Undoubtedly, such a provision

imparts an element of elasticity to the export duties, conditions regarding the application of which are subject to frequent changes in the light of altered international market. The Committee are conscious of the objections made in certain quarters to the grant of any such powers to the Government on the ground that representatives of the people in Parliament may not have an opportunity of examining the desirability of the action proposed to be taken by the Government. While not questioning the validity of this objection, the Committee would point out that international conditions change so rapidly that the time taken in obtaining the prior approval of Parliament may sometimes prevent immediate action being taken by the Government to suit the altered situation in the export markets. Provision should, however, be made for obtaining the approval of Parliament as soon as possible after the duties are varied by executive action.

On the other hand, the Committee are not aware whether there is any administrative machinery which watches and scrutinises carefully the effects of these duties on the various industries and trade and on the extent to which the sale of Indian goods is affected thereby; and the competitive position of Indian industries in foreign markets is reduced as a result of the export duties. As they have explained in Annexure II, the present system is not working quite satisfactorily. The inordinate delay made by the Government in reducing the export duties on certain commodities and the refusal by them to take any action in respect of some others would suggest the need for devising a more suitable machinery for the purpose.

Question 115

At present cesses are imposed on the export of certain commodities with the object of utilising the proceeds thereof for promoting the export trade of the particular commodities concerned as well as for purpose of internal research and development of the goods. Mention may, in particular, be made of the cess imposed on export of Tea. By the very nature of things, the rates of these cesses are much lower than the export duties and do not generally have much effect in increasing the prices of the goods in the export market. The Committee are not in favour of the proceeds of the export duties, as distinguished from cesses, being funded for financing schemes for promoting long range development of the export trade, the necessary expenditure should be met out of general revenues.

Question 116

No.

Central Excises

Questions 117 & 118

A. As was stated in the Preliminary Memorandum submitted by the Committee, excise duties are generally not welcomed in view of their incidence on the prices of the commodities on which they are imposed. At the same time, the Committee feel that it may not be possible for the Government to forego the substantial revenue which they now earn from the Central Excise. In view of this, the Committee consider that the list of commodities on which duties are now imposed should be very carefully scrutinised and some of the commodities, at present subjected to duties, should be exempted from the list. The considerations which should weigh with the Government in this respect are stated below:—

In the first place, while the Committee believe that the industries which have been developed as a result of protection granted by the Government may, under certain conditions, be asked to bear the burden of excise duties, they are at the same time of opinion that those which are not so protected should generally be exempted from the payment of such duties. Even in respect of the former category of industries, care should be taken so as not to increase the burden on the consumers who, even otherwise, have to pay higher prices as a result of protection. On the other hand, the excise duties should not be so imposed as to counteract the benefits of protection to the industries concerned.

In the second place, the industries which manufacture essential consumer goods should generally be exempted from the payment of duties.

In the third place, there are industries which may, in prosperous times, absorb the incidence of the excise duties without either passing on the same to the consumers or incurring losses. At times of depression, however, these industries may not be able to pass on the tax to the consumers, either can they pay the same out of their profits and, consequently, have to suffer loss of markets or to sell their goods sometimes at losses. This consideration is particularly important in the case of industries having export markets.

It is, therefore, necessary that there should be some machinery according to which certain particular com-

modities may be exempted either wholly or partially from the payment of excise duties, even if on a temporary basis, whenever the situation so warrants:

B. Examining the present list of commodities, the Committee would in particular refer to the duties on Motor Spirit, Cotton Cloth, Tea and Vanaspati.

(i) Motor Spirit

As regards motor spirit, the Committee are of opinion that taxes on road transport should be as much liberalised as possible. Some of the existing taxes have been covered by the Taxation Enquiry Commission in Part V of their Questionnaire, and the detailed views of the Committee on the particular issues raised in these questions will be expressed in the appropriate place. But so far as excise duties on motor spirit are concerned, the Committee are definitely of opinion that motor spirit should be taken off the list, or at least the rate should be reduced to a reasonable level.

(ii) Cotton Goods

As regards cotton cloth, the Committee would draw attention to the fact that, while production has, in recent months, increased considerably and has almost reached the target fixed for 1955-56 under the Five-Year Plan, the industry is facing a very stiff consumers' resistance in the disposal of its products. Large stocks are reported to be accumulating either with the mills or with the dealers in spite of the fact that, considered from the point of view of per capita requirements, the industry cannot be said to have reached a stage of over-production. The reason for this paradox appears to lie in the too high prices of cloth compared to the purchasing power of the people. As in the case of many other industries, the Cotton Textile Industry suffers from a very high and rigid cost structure. There has actually been a very large increase in the prices of raw materials, stores, etc., on the one hand and wages on the other. An additional factor which has contributed to rise in prices is the excise duty which was imposed in 1949 and has since been gradually so stiffened as to account for as much 5 per cent. to 15 per cent. of the retail prices of the goods according to their different varieties.

The rates of duties which are imposed on the various kinds of cotton goods are mentioned below:—

Superfine cloth, i.e., cloth in which the count of warp yarn is 48 s or finer . . .	Re. 0-3-3 per yard.
Fine cloth, i.e., cloth in which the count of warp yarn is 35 s or finer but does not exceed 47 s . . .	Re. 0-1-3 per yard.
Medium and coarse cloth, that is to say, in which the count of warp yarn does not exceed 34 s . . .	Re. 0-0-3 per yard.

Besides, an additional excise duty at the rate of 3 pies per yard is leviable on all cloth under Section 3 of the Khadi & other Hand Loom Industries Development (Additional Excise Duty on Cloth) Act, 1953.

It is clearly not possible for the industry to make any reduction in the prices of raw material, wages, etc., over which it has no control, neither is there any scope for further minimising its profits, which are already too low. As a matter of fact, prices of goods, though comparatively high, have not risen proportionately to the increase in the costs. Even so, the present prices are much below those prevailing a few months ago, thus reducing the already narrow margin of profits, to the mills.

The only way left for bringing down to some extent the prices of cloth within the purchasing power of the people is thus to withdraw the excise duty.

There are two further points about the excise duties on cotton goods which may be mentioned here. In the first place, till recently, the duties on fine and superfine cloth were *ad valorem*, the rates being 5 per cent. and 20 per cent., respectively. The basis has, however, been changed with effect from the current financial year to specific duties as per Schedule referred to above. In justifying this change, the Finance Minister pleaded administrative convenience and did not expect any increase in the revenue. The Committee have no information as to the details of "the administrative difficulties and the continual friction between the mills and the assessing staff on the question of the adequacy of the declared prices", referred to by the Finance Minister, but they would point out that while, as a result of the change in the basis, the Government are actually earning larger revenues, the consumers are not getting the full benefit of the fall in the prices of goods.

Secondly, the Committee has strong objections to the imposition of an additional excise duty only with the objective of utilising the proceeds thereof for the development of handloom industries. While they would naturally welcome all reasonable steps being taken for developing the handloom industry, they cannot find any

justification for imposing a handicap on the cotton mill industry, already faced with a number of difficult problems, for the purpose. Though it may not be strictly relevant to the present discussions, the Committee would also refer to the restrictions on the production of mill-made dhuties imposed by the Government for enabling the handloom industry to market its products. This restriction is in addition to the special excise duty of 3 pies per yard on all mill-made cloth and has been acting as a severe brake on the progress of the cotton-mill industry.

(iii) *Tea*

In their preliminary memorandum, the Committee had referred to the crisis through which the Tea Industry had passed in 1952 on account of the great fall in the prices of tea. These difficulties were accentuated partly by the heavy burden of excise duties which the Industry had to pay on all tea grown and which it was unable to pass on the consumer. The Industry has since passed over the most acute stage of its difficulties, but only after it had suffered heavy losses, and it is unfortunate that the Government did not at the time give adequate consideration to the need for giving any relief to the Industry. One of the most important steps which the Government were requested to take at the time was either the total abolition of the excise duty or at least an adjustment of the duties on a sliding scale according to the variations in the quality and price.

The Committee are however, glad to note that the Government have since given some relief to the Industry by reducing the rate of the excise duty on all tea other than package tea to as. 1 per lb., and imposed the duty of as. 4 per lb. on all package tea, i.e., tea packed in any kind of container containing not more than 60 lb. net of tea.

The Committee have been informed that, in the existing circumstances, the Tea Industry has not much to complain against the new rates of duty. But they would, at the same time, draw attention to the fact that the Government should have a machinery, like the one suggested above in reply to Question No. 114, for watching the incidence of the duty on any Industry which may, during a particular period, be unable to bear the burden of the duty.

(iv) *Vanaspatti*

The existing excise duty of Rs. 7 per cwt. or a. 1 per lb. on Vanaspatti is, in the prevailing conditions, bearing very heavily on the Industry. There has been an extra-ordinary spurt in the price of the raw groundnut oil, which has steadily gone up during the last few months from Rs. 52 in January last to about Rs. 85 in July. The resultant increase in the price of Vanaspatti appears to be much too high for the limited purchasing power of the average consumer, and is leading to a reduce offtake of the finished products and forcing a curtailment of the production of the Industry. On the other hand as Vanaspatti has now become an essential item of food in India because of its use as a universal cooking medium in place of ghee, there is a strong case for reducing its price to the consumer. The Industry is, however, unable to bring down prices, because of the very high prices for its base raw material and its inability to reduce the other charges, and the abolition of the excise duty would appear to be the only method of achieving the object.

Question 119

No comments.

Question 120

The Committee have no information on the point.

Question 121

No comments.

Question 122

The Committee agree that part of the proceeds of the excise duties should be earmarked for expenditure on research and development schemes designed to improve quality and marketability of the commodities.

They would, however, draw attention to the observations made by them above in reply to Questions Nos. 117 and 118 in regard to the imposition of an excise duty of three pies in the rupee on mill-made cloth for the development of the handloom industry. As they have already stated, they are strongly opposed to the imposition of a duty on any large-scale industries for utilising the proceeds thereof for the development of the competing cottage industries. This objection is not confined only to the cotton mill *vis-a-vis* handloom industries, but to all other industries as well.

Questions 123

Please refer to the answers made in reply to Questions Nos. 117 and 118.

Salt Duty.

Question 124

The Committee presume that the suggestion for the re-imposition of the excise duty on salt has been made in the belief that, while its incidence on the individual consumer may not be very high, the duty will yield considerable revenues to the Government. While the Committee generally agree with this suggestion, they are, at the same time, of opinion that, in a matter which had played such a big role in the National Struggle for Freedom, due consideration should be given to a few other equally important points.

In the first place, it is not perhaps widely known that, simultaneously with the abolition of the excise duty on salt on the 1st April, 1947, the Government also imposed a duty at the rate of as. 2 per standard maund on all salt removed from a licensed salt works or factory, and as. 3-3 pies per standard maund in the case of removal from any salt factory or source administered by the Central Government. The Committee are not aware of the reasons why this levy was imposed at the time of the withdrawal of the excise duty, thus nullifying its beneficial effects, neither have they any information as to the volume of revenue which the Government secure from this special levy. In any case, they are definitely of opinion that, if at all an excise duty is re-imposed on salt, this special levy should be withdrawn.

In the second place, the Committee are of opinion that salt used for industrial purposes should be completely exempted from the payment of any duty or cess, in order to relieve the consuming industries of any unnecessary burden. They believe that there will be no objection to such a suggestion. But they would, at the same time, point out that, if industrial salt is excluded, the net yield of the revenue may not be such as would justify the Government to incur popular displeasure by re-imposing the excise duty on salt.

The Committee would, in this connection, also suggest that, even if no excise duty is re-imposed, the Government should, in modification of their present policy, exempt industrial salts from the liability to pay the special levy at present imposed.

In the third place, an excise duty on salt, will have to be paid on the entire quantity of salt *manufactured* as distinguished from the present levy in the case of *removal* from the salt factory. This would naturally interfere with the present practice of the salt manufacturers of not despatching outside their factory any salt which does not conform to the standard specification laid down by the Government regarding the quality of their products, and the manufacturers will be tempted to market even sub-standard quality having already paid their duty thereon.

The Committee hope that, in formulating their views on the question of the re-imposition of the salt duty, the Commission will kindly take into account the observations made above.

Tax on the Sales or Purchase of Goods and on Advertisements.

Question 125

Answer to both the questions is in the negative.

Question 126

(i) (a) For reasons mentioned in the question itself, the Committee are opposed to the imposition of a tax on the sale of newspapers.

(b) The Committee are also opposed to the imposition of tax on advertisements whether appearing in newspapers or not. The reasons are stated below.

(ii) In the opinion of the Committee, the burden of tax is already heavy in India, and trade and industry are hardly in a position to bear further imports. In the circumstances, a very strong case will have to be made out before either the Centre or the States or the Local Authorities decide to levy a new tax.

In regard particularly to the question of taxing advertisements, due account has to be taken, in the first place, of the very high basic charges which are at present made both by newspapers or other agencies for advertisements. An additional levy, by way of sales tax or licence fee, will force many industrial and commercial undertakings to reduce their advertisements and publicity schemes. Indian concerns, particularly small and medium-sized industries, will be more adversely affected as they will have to face severe competition from foreign undertakings who, with their huge financial resources, are in a position to insert costly advertisements including newspaper publicity to maintain and develop the market for their products and oust the Indian manufacturers from the field.

Secondly, in imposing any sales tax on advertisements, the Central Government must take into account any license fee that may already have been imposed thereon by Local Authorities. The Committee have no information about such fees having been levied by

Local Authorities in other States, but they would draw attention to the fact that the Calcutta Corporation have recently imposed heavy license fees for advertisements in the teeth of opposition of trade and industry.

Question 127

The question implies taxation at source, about the advisability or otherwise of which, the views of the Committee are stated in a latter paragraph.

A. The Committee would answer the first part of the question in the negative. For, in respect of the goods manufactured or produced within the State or those imported into the State from abroad, the States have at present no constitutional competence to levy Excise or Customs Duties or surcharge thereon. They may, however, impose tax on such goods only at the point of sale at rates which may, and actually do, vary from State to State. Sales tax leviable by the States, is not, therefore, an extension or increase of Excise or Customs, as suggested in the Question.

As regards Octroi or terminal tax, the competence of the States to impose them is also not free from ambiguities as while taxes on the entry of goods into a local area for consumption, use or sale therein, and taxes on goods carried by road or inland waterways are included in List II of the Seventh Schedule of the Constitution Act, terminal taxes on goods carried by Railway, Sea or Air are a Union Subject. In practice, however, Octrois are imposed only by Local Bodies on goods entering into their respective territorial jurisdictions and, while an Octroi would necessarily be a tax even on goods entering into a particular local area even from other parts within the State itself, a sales tax imposed by a State will not be discriminatory in character being charged at the same rate as will be applicable to the goods manufactured within the State as a whole.

B. It will, therefore, appear that sales tax as such has a specific function to perform in the country's system of taxation. Besides, in a Federal Scheme of Taxation, the proceeds unlike those of Excise and Customs, are to be allocated to the particular States levying the same.

C. The Committee would at the same time draw attention to the fact that if, as suggested by them later, sales tax is imposed *not by the States* but by the Centre, sales tax may, under certain circumstances, partake of the character of Excise and Customs. There are two possible alternative methods in which the tax may be collected by the Centre. In the first place, unlike Excise Duties which are paid at the time the goods are manufactured and the Customs which are collected at the time of importation, sales tax may be leviable only when the goods are actually sold by the manufacturers or the importers as the case may be. Such a procedure has the advantage of not compelling manufacturers and importers to pay the tax beforehand on the entire volume of goods manufactured or imported, even before they are sold. Or, in other words, the manufacturer or the importer, as the case may be, need not under this system lock up a part of his capital for an uncertain period of time, and thereby lose interest thereon and also pay tax on goods which may not ultimately be sold by him. The Committee have been informed that though, generally speaking, such a system of payment of tax only at the time of sale will be welcomed by the manufacturers and the importers for obvious reasons, there may be certain administrative difficulties which would be obviated in case sales tax is imposed at the time the goods are actually manufactured or imported. They are not in a position to examine the administrative complications of the two systems but they would point out that if sales tax is imposed at the time the goods are manufactured or imported, there would be very little difference between the sales tax on the one hand and Excise and Customs on the other. In such an event sales tax at a uniform rate may be levied by the Centre in the form of surcharges on the existing excise and customs duties and a fresh tax in the case of those goods which are now exempted from the payment of excise duties and/or Customs.

In the case of a sales tax imposed by the Centre there will not naturally be any question of imposing a tax on the goods transported from one State to another, and the question of similarity with Octroi or terminal tax will not arise.

As regards the wider question of the suitability of imposing sales tax at the source, the following points which have a special relevance to the system of taxation now prevailing in West Bengal, may be brought to the attention of the Commission.

It has been pointed out that, if the tax is imposed at source, the large number of registered dealers, who are required at present to maintain various forms and books and to incur considerable expenditure for complying with the tax regulations, will be saved this trouble and that the new system will be advantageous also to the manufacturers and importers in so far as they would be saved the trouble of maintaining separate

accounts with the large number of registered dealers and the far larger number of unregistered dealers, and will be able to satisfy the taxing officers about the actual value of total sales made by them (subject to the usual exemptions) from their books. The Government, on their part, will also stand to gain from the new system as the scope for evasion will be considerably minimised and they will be able to collect much larger revenue than at present, at a much less cost.

On the other hand, there are certain other points which have to be considered in this connection.

In the first place, as it may not be possible to levy the tax on all manufacturers scattered all over the country the question as to which categories of manufacturers will be required to pay the tax will have to be determined. It has been suggested that only those factories, which are registered under the Factories Act, should be brought within the scope of the Scheme, others being excluded to minimise the cost of administration and administrative complications. In such an event, quite a large number of manufacturers who are not at present registered under the Factories Act or who are carrying on their activities on cottage industry lines will be exempted from the payment of the tax. The question as to whether this would lead to any undesirable competition between large and small industries has to be examined in this connection.

In the second place, while there may not be any complication in regard to the sales within the State of the goods thus manufactured or those imported from outside India, some difficulties are, however, expected to arise in the case of sales of these goods outside the State. On the principle that exports to places outside the State would be exempted from the payment of tax, the manufacturers or the importers will not be liable to pay any tax on sales made by them direct to parties outside the State. But, in those cases where sales to outside the States are not made direct by the manufacturers or importers, and which pass through a number of dealers, the particular dealer who exports the goods will, though exempted from paying the tax at the point of export, be in an unfavourable position *vis-a-vis* the manufacturer and importer, having already paid the sales tax on the goods when purchasing from the manufacturer or the importer or from other dealer as the case may be. The question as to whether a refund of the duty may be made to the exporting dealer in such cases is also bristled with some difficulty inasmuch as it will not be possible in many cases, particularly where the goods pass through a number of stages, to ascertain the exact amount of the tax paid on the particular goods which are to be exported. Under the existing law, the dealer, if registered under the Act and exporting the goods outside the State, is not required to pay this tax.

In the third place, so far as goods imported from other places within India are concerned, an effective enforcement of the tax would require the posting of check-posts at every Railway Station, Air Port and riverine points which may not be quite feasible from the administrative point of view. There will also remain the possibility of large quantities of goods crossing the State boundary by the road and, in some places, also by river routes. A further point to be considered, in this connection, is analogous to the one mentioned in the preceding paragraph and arising out of "exports" from the State to a third State of goods 'imported' from a second State.

As already stated, however, the difficulties about taxing good passing from one State to another will not arise if the tax is imposed by the Centre.

Question 128

(a) Yes.

(b) The Committee do not consider that there are any article to which the particular system adopted in respect of Petrol should be extended.

Question 129

(i) A. Apart from the alternatives mentioned in the Question, there is another variety of sales tax, *viz.*, single-point tax levied at the source. Though, under this system, all manufacturers and importers will necessarily have to register their names with the Sales Tax authority, there would be no exemption from tax on sales by one registered dealer to another registered dealer and no question of exclusion from compulsory registration of a dealer below a certain limit of turnover will arise except, as mentioned in answer to question 127, the factories not registered under the Factories Act and cottage industries will be exempted from the payment of the tax. The system will provide for a large number of exempted goods as well as, (in the case of sales tax being a State Subject), of exempted transactions like exports to outside the State and also perhaps to Government Departments.

B. The Committee consider that, under the particular variety of single point system which they are

recommending sales tax will continue to be as significant a source of State revenue as at present and, if certain other steps are also taken such as would minimise the chance of and inducement to evasion, sales tax may even yield a much larger revenue than at present.

(ii) As stated above, the Committee are in favour of a single point tax levied at the source.

(a) Consumer

Single point tax will impose a lesser burden on the consumers than the multiple point tax. The single point tax in West Bengal, for instance, is 3 pice in the rupee. If this is replaced by the multiple point tax, or say, 1 pice in the rupee, the burden will be heavier unless of course, the stages through which the goods pass were limited to a maximum number of three.

As a matter of fact, however, there are large number of goods which pass through more than three or four stages and, unless the rate of tax per rupee is fixed at a lower level than 1 pice in the rupee at each point, the burden will definitely be higher on the consumers than under the existing single-point system.

Besides, the Committee do not rule out the possibility of a reduction in the existing rate of tax in West Bengal under the single point system, and they believe that, if at any time it is considered advisable to fix the total rate at the final point of retail sale at 2 pice in the rupee, there would be considerable complications in adjusting the rates at different stages of sale under a multi-point system.

A further advantage of the single-point system to the consumer arises from the large number of exempted goods which do not bear any tax at all at present,—an advantage which may not be available in the case of a multi-point system of taxation.

(b) Dealer

The multi-point system, though levied at a relatively low rate, is likely to place the dealers in a comparatively disadvantageous position *vis-a-vis* the importer and manufacturer, as the latter will have the advantage of a lower rate of tax in the case of export to other States. Further, under the multi-point system even small dealers will not be excluded though it is hardly possible for such dealers to keep detailed accounts of sales, etc. On the other hand, the single-point system, as is now being administered in West Bengal, places the dealers also under certain handicaps as the list of registered dealers to whom sales are to be made free of tax is not, at any particular point of time, complete and any dealer may, on the strength of a certificate (which may have since been cancelled), obtain goods from any registered dealer free of sales tax, thereby making the latter ultimately responsible for the payment of the tax. Besides, many non-*bona fide* parties manage to get their names registered and help non-registered dealers in getting their goods without payment of sales tax, through their registration certificates, thereby getting some commission for same and also placing the genuine registered dealers in a disadvantageous position, as ultimately genuine registered dealers have to pay tax to the Government for sales made to the consumers or to non-registered dealers while non-registered dealers obtaining the goods from non-*bona fide* registered dealers will not have to pay any such tax. The system of registered dealers which is an inseparable part of a single-point system also makes it necessary for the dealers to maintain an elaborate accounting system indicating sales to registered and non-registered dealers in separate ledgers.

(c) Industry, trade, etc.

The difficulties mentioned above under (b) are also generally experienced by industry, trade, etc.

(d) Government

Under the single-point system, as obtaining in West Bengal, the Government are losing much revenue on account of evasion of tax on a large scale. On the other hand, though, the scope for evasion is likely to be minimised under the multi-point system, the cost of administration will go up as the number of dealers to be covered will be very much more than under the single-point system.

(3) (i) The existing system of sales tax undoubtedly leads to a greater burden being placed on the consumer than is accounted for by the proceeds which accrue to the Exchequer.

In the first place, the Committee believe that the present system necessarily implies a vast administrative machinery entailing proportionately much larger expenses than is accounted for by the amount of the tax collected.

In the second place, the system leaves considerable scope for evasion and to the extent that the dealers, who evade the payment of the tax, charge the amount of the tax to the price of the goods sold by them, the consumers pay tax which is not credited to the revenue of the Government. On the other hand, there are some

dealers who do not add to their price the amount of the tax evaded, and, while not increasing the burden on the consumers, nevertheless under-quote their competitors who pay the tax to the Government and collect the same from the consumers. In the majority of cases, however, the dealers who evade the payment of tax to the Government add only a part of the amount of the tax to the price and, while under-quoting their competitors, also misappropriate a portion of the tax collected by them from the consumers.

(ii) No.

(iii) The Committee have no information.

(iv) The chief complaint against the system of sales tax as obtaining in West Bengal is that it has left room for large scale evasion which has not only placed the *bona fide* dealers in competitive disadvantage *vis-a-vis* the non-*bona fide* dealers but has also involved large financial losses to the Government.

The Committee are, however, of opinion that the scope for evasion will be considerably minimised if sales tax is centralised.

Question 130

(i) No.

(ii) If, as suggested below, a sufficiently large number of articles are exempted altogether, it will not be necessary to impose special rates of levy, lower than the ordinary rate for certain articles. The question will arise only in respect of those articles, mentioned in (iii) below, which are not so exempted altogether.

(iii) In the opinion of the Committee all goods which are:—

- (a) essential for the life of the community,
- (b) raw material for industry, and
- (c) so low priced in retail sales as would make sales tax fractional and incapable of being passed on to the buyer, and also imposing at the same time, in the aggregate, an undue burden on the dealers or manufacturers

should be exempted altogether from the scope of the tax.

As regards the essential goods, the Committee would point out that the exemption should cover all articles that enter into the life of the community, covering such items as food, clothing and housing. Reference may, in this connection, be made to the list of goods included in the Schedule to the Essential Goods (Declaration and Regulation Tax on Sale or Purchase) Act, 1952. This Act was passed with a different objective, namely, of ensuring uniformity of rates of sales tax throughout India on the goods declared to be essential by the Act, but most of the Articles listed in the Schedule to the Act are such as would qualify, on a dispassionate study, for total exemption. The list is not, however, exhaustive, and would require considerable additions for the purpose of total exemption.

The Committee note that the following articles have been included in the list:—

1. Cereals and pulses in all forms, including bread and flour, including atta, maida, suji and bran (except when any such article is sold in sealed containers).
2. Fresh and dried fruits, sugar-cane, coconuts, vegetables, edible tubers, vegetable and flower seeds, bulbs and plants, excluding orchids (except (i) any medicine prepared from any one or more of such articles; and (ii) when any such article is sold in sealed containers).
3. Fresh milk, whole or separate, and milk products, including butter, ghee, chhana, khoa, but excluding sweetmeats.
4. Meat, fish and eggs (except when any such article is sold in sealed containers).
5. Edible oils, and oilseeds from which edible oils are extracted.
6. Gur.
7. Salt.
8. All cloth, woven on hand-looms, and all cotton cloth made in mills or woven on power-looms in which the count of warp yarn employed (excluding the border) is below 35s (whether single or folded).
9. Raw cotton, including ginned and unginned cotton or kapas, cotton thread, cotton yarn, cotton seeds, jute seeds, raw jute, sun-hemp, and mesta.
10. Hides and skins.
11. Fertilisers and manures, agricultural machinery and implements, including parts of such machinery and implements.
12. Cattle foods.
13. Coal including coke and other derivatives, petroleum and petroleum products, including kerosene and motor spirit.

14. Iron and Steel.

15. Books, exercise books, slates and slate pencils and periodical journals.

As has already been stated, the list is not exhaustive, and the Committee would suggest that it should be improved by including in it, among others, the following equally essential items many of which are, it may be noted, exempted from sales tax in West Bengal at present :—

- (1) Vanaspathi (which is much cheaper than Ghee, included in the aforesaid exemption list), and is now a popular cooking medium ;
- (2) Water (but not aerated water and mineral water when sold in bottle or in sealed container) ;
- (3) Sago (i.e., any article sold in the market by the name of sago) ;
- (4) Cooked Foods other than cakes, pastries and Sweetmeats (except when sold in sealed containers) ;
- (5) Livestock, including poultry ;
- (6) Tobacco for Hookah ;
- (7) Quinine ;
- (8) Drugs and medicines except patent medicines ;
- (9) Fire Wood, one of the commonest fuel in the rural areas particularly for the preparation of food ;
- (10) Timber, Cement and Bricks, which are equally important, in some cases perhaps more than Iron and steel included in the exempted list, in providing cheap housing to the people ;
- (11) Electrical energy, which is as much a power generating agency as coal, etc., included in the exemption list ; and
- (12) Matches.

Question 131

A. The Committee have all along been in favour of uniformity between the different States in regard to the imposition of sales tax. In advocating this uniformity, they have always laid greater stress on the desirability of removing restrictions on the free flow of goods from one State to another—a matter to which reference has been made in answer to Question No. 133. In so far as the particular points mentioned in Question No. 131 are concerned, the Committee would point out at the outset that the divergence in the system of taxation in different States, viz., multi-point or single-point, does not necessarily lead to lack of uniformity provided there is no difference in the rates ultimately charged at the retail stage or in the lists of exempted goods and transactions.

There is, however, no doubt that if different States charge varying rates of tax, the wholesale market will be shifted to a State charging a lower rate. Much the same result will ensue from the different lists of exempted goods in different States.

As for exempted transactions, the Committee have been informed that the sales made by dealers in West Bengal to the various Government Departments have recently been subjected to sales tax. This is not in itself open to serious objection, but the withdrawal of the exemptions previously enjoyed by such sales can be justified only if sales to these authorities are also subjected to taxes by other States. For otherwise, suppliers in West Bengal and other States not enjoying such exemptions, will be placed in an unfavourable position *vis-à-vis* their competitors elsewhere. The Committee, however, recognise that there may not be much objection to tax these sales if they are also liable to tax in all the States.

Complaints have, in this connection, been made about difficulties experienced by the suppliers in West Bengal in realising tax on sales of stores to the Directorate General of Supplies and Disposals. Though from 1950, the Central Government Departments agreed to pay tax on all deliveries within West Bengal, in terms of the State Sales Tax law they refused in 1952, following an interpretation of Article 286 of the Constitution by the Attorney General, to pay taxes on deliveries to their local transit depots for ultimate consumption outside the State. The Government of West Bengal, on the other hand, are demanding sales taxes on all deliveries within the State even though the ultimate consignee is outside ; and as a result of this difference of opinion between the Central and the State Governments, the suppliers are being put to unnecessary harassments and losses.

It is necessary that suitable steps should be taken to bring about a uniformity in regard to all these points. The best method according to which this objective may be attained is being considered in the following section.

B. As the Committee have already stated, lack of uniformity in rates and exemptions are not the only

points in regard to which the system of sales tax, as prevailing in the country at present, is now open to criticism. The administration of sales tax has also given rise to a number of other difficulties, the most important of which are :—

- (i) the considerable scope for evasion of the tax which exists at present resulting in a large number of honest tax-payers being unfairly handicapped, and
- (ii) the harassments caused by the Government of one State in imposing their sales tax legislation on the dealers having their principal place of business in other States but exporting their goods to the former State.

All these difficulties may be removed only if, apart from removing the factors which at present encourage evasion and, subject to the tax being levied at source, the Constitution is amended so as to include the item of sales tax as a whole in the Union List. The Committee of the Chamber have, in common with other commercial organizations, all along been pressing for making sales tax a Central Subject. While unfortunately their demand in this respect was not accepted by the framers of the Constitution, the experience of the last few years has amply confirmed the apprehension, expressed by the commercial community earlier, about the chaos that would be caused by the power given to different States to impose sales tax within their territories at rates and systems determined by them.

In answer to question 127, the Committee have expressed their preference for a system of sales tax levied at the source. They have also indicated in appropriate place some of the difficulties which might be experienced in giving effect to this suggestion if sales tax remain as a State Subject. Some of these difficulties relate to the :—

- (a) payment of refund to dealers who, having already paid tax either to the manufacture or to the importer, would have to bear the burden when exporting the goods to outside the State, and
- (b) the collection of sales tax at the point of entry to a particular State.

In the case of a Central tax, levied at source, it would be possible to provide that all goods whether produced within the country (subject to the qualification mentioned in answer to Question No. 127) or imported from outside will pay tax at source, and while no exemption will be made in case of export from one State to another, no tax will also be collected at the point of entry to any State. If such a provision were made, the difficulties mentioned above will be completely eliminated.

The further fact that the system of registered dealers as now in operation will be abolished, and also that the tax will be collected from :—

- (a) all manufacturers who are registered under the Factories Act and are as such even now under same administrative control, and
- (b) all importers, complete records about whom are maintained by the Customs authorities.

will make the administration much simpler, cheaper, efficient and, the Committee would add, also honest. The harassments will be reduced to the minimum and the scope for evasion extremely limited.

C. The Committee realise that the question of apportionment of the proceeds of a tax, levied by Central Legislation, to the various States is not an easy one. As some of the States at present secure a much larger revenue from Sales Tax than others, they may quite conceivably feel apprehensive of loss of revenue as a result of loss of freedom to manipulate the rates of taxation and lists of exemptions or to change the basis of taxation from multi-point to single-point or *vice versa*.

The Committee would, on the other hand, point out that, even under a Federal Scheme of Finance, as is now in operation in India, the comparative volume of State Revenues as such has lost much of its significance as a result of the adoption of the Five Year Plan. The various Development Schemes in the Public Sector have been allocated to the Centre or the States according to the existing allotment of their respective resources. The Plan having been formulated in consultation with the States and finalised with their concurrence, the States can no longer be regarded as completely autonomous as was perhaps contemplated by the framers of the Constitution, and the question as to what particular source of revenue is to be allotted to the States should now be considered more as one of convenience than of distribution of functions under an orthodox Federal Structure.

Subject to these observations, the Committee consider that the best way of apportioning the proceeds of the tax to the States would be to refer the matter to the Finance Commission for enquiry and recommendation. In examining the matter, the later may be

asked to take into account the origin of the tax and the consumption of the goods, subjected to the tax, in the different States in order that no unfair weightage is given either to the States where larger amounts of tax are collected or to those where the goods concerned are consumed.

D. For reasons, already stated, the Committee are in favour of complete centralisation of Sales Tax, the proceeds being distributed among the different States on a fair basis.

They have, in this connection, also examined the other alternatives mentioned in Question No. 131, and their views thereon are stated below :—

(i) A formal or informal convention, if arrived at, will undoubtedly bring about some uniformity in regard to the rates of taxation and the exemptions. This procedure is, however, open to at least two objections, viz.,

(a) The convention may not be applicable to the particular system of taxation, viz., multi-point or single-point. Besides, the scope for evasions within the State and harassments will remain.

(b) Lacking Constitutional sanction, the Convention may not always be strictly followed by some States which may, for some reason or other, consider it necessary to vary the rates and the lists of exemptions.

Besides, if the States agree to establish a Convention which they have every intention to honour, they may also agree to an amendment of the Constitution.

(ii) Central Legislation, promoted at the instance of two or more States, will serve the same object as Central Legislation for all the States, as envisaged in sub-para. (iv) but only with a limited scope. Complications will remain in the States which would not join the scheme and in respect of transactions between these States *inter se* and between those States and those which would enter into agreement.

(iii) The extent to which Constitutional amendment, so as to include certain basic matters connected with sales tax in the Concurrent List will be able to solve the problem will depend upon the nature of the "basic" matters to be so covered. Besides the constitutional limitations of concurrent jurisdiction over matters in respect of the existing State Laws will also have to be examined.

(iv) Having regard to the observations made above, the Committee are of opinion that an amendment of the Constitution so as to include Sales Tax in the Union List is the best solution. The reasons have been elaborated in B above.

Question 132

A. The need for retaining Article 286 in the Constitution arises out of the existing Constitutional pattern of Sales Tax and would be obviated if it is made a Central subject.

B. Not much uniformity has been achieved in regard to exemptions (in favour of "goods essential for the life of the community") under Clause (3) of the Article because the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act, which was passed two years and a half after the inauguration of the Constitution and received the assent of the President on the 9th August 1952, confines the scope of the Act only to those State Laws which may be made **after the commencement of the Act**. All the existing taxes even on the goods declared by the Act to be essential may continue with immunity. The long time lag between the inauguration of the Constitution and the enactment of the Act has further given an opportunity to a few States to make further changes in their respective laws, while the interval between the publication of the draft Bill and its final passage had also enabled some of those States to anticipate all that has now been done by the Centre.

It is understood that, following the Finance Ministers' Conference held in October last year, the Government of India had requested the State Governments to amend their pre-existing laws so as to bring them in conformity with the spirit of the Essential Goods (Declaration and Regulation of Tax on Sales or Purchases) Act but, as far as the Committee have been able to ascertain, nothing much has been done by the State Governments in this respect. The Government of India also have, in a letter to the Federation of India Chambers of Commerce and Industry, expressed their inability to do anything more in the matter as the Act does not apply to the pre-existing State Laws and the decisions to amend such laws as proposed rests primarily with the State Governments concerned.

C. The Committee are of opinion that the list of the goods included in the Schedule to the relevant Act is on the whole satisfactory. But as they have already stated, most of these goods would qualify for exemption whether under a Central Act or the State Laws.

At the same time in the existing circumstances of different systems of Sales Tax in the various States, with full right for the States to vary the lists of exemptions and rates of taxation, a Central Act ensuring uniformity of rates in respect of a number of commodities will, if properly framed, restore some order in the chaos.

The principles which should be followed in determining the list are that all goods which are essential for the life of the community and which are used as raw materials for the manufacture of essential goods should be brought within the scope of the relevant Act. Particular attention should be given to food, clothing, housing, education and medical treatment of the poorer sections of the people, and those items which, by their nature, quality and price, enter into their life should be brought within the scope of uniform taxation. From this point of view, the exclusion of Vanaspathi, Firewood, Cement, timber, bricks, drugs and medicines, from the list appears to be rather unfortunate.

D. As mentioned above, the scope of the provision contained Clause (3) of Article 286 should be extended also to "essential articles" which had been subject to sales tax before the Essential Goods Act come into force.

Question 133

(a) The inclusion of Article 286 in the Constitution was at the time hailed as a great concession by the commercial community who had naturally been disappointed at the rejection of their basic demand for centralisation of Sales Tax. But, as in the case of essential goods, the relevant provisions relating to Inter-State Commerce have also failed to achieve the objective which the framers of the Constitution had in mind. The judgments of the Supreme Court have clearly shown whatever might have been the intention of the Constituent Assembly, the Article has not removed impediments to inter-State trade and commerce for it gives power to a State to collect sales tax from dealers in other States on their sales to the dealers in the former State, even though it is convenient for all concerned if the tax is collected only from the dealers residing within the State. As a result, dealers in one State have not only to be registered under the Sales Tax Laws of a number of other States but also to be conversant with the rates of taxation, lists of exemptions and other rules and regulations in all these States which, again, are subject to changes from time to time. They will also have to maintain separate books of accounts in respect of sales to different States. Further, they may be required to produce books and present themselves before the Taxing officials of the outside States, sometimes conceivably at the same time. Apart from the harassments thus caused to these dealers, the power thus predicated to the States definitely obstructs inter-State trade and commerce.

The Committee do not feel competent to make specific suggestions regarding the remedies which may remove the defects in the Constitution, but they feel that the Commission will carefully examine the judgments of the Supreme Court and make their own suggestions in the light of the issues raised therein.

(b) The Committee believe that unless it is possible to centralise sales tax, it would be much better to provide for a Purchase Tax in order that the tax jurisdiction of each State might be confined to parties residing within the State.

The Committee are not in favour of a mixed system in which purchases should be taxed in certain cases and sales in certain others. This would not, in their opinion, be practicable and will also introduce a number of complications.

Question 134

The Committee have already answered this question in the affirmative. The only effective solution would be centralisation of sales tax.

State Excises

Question 135

(a) (i) The Committee had dealt in detail in their preliminary memorandum with the system of levy of State Excise Duties in different States. For the purpose of ready reference the observations made by them in the aforesaid memorandum are reproduced below. The Committee have no further comments to make on the question, except reiterating that it is absolutely essential to ensure uniformity in the matter between different States.

Among the State Excise Duties, the most important, as far as trade and industry are concerned, are those imposed on the medicinal and toilet preparations containing alcohol. The different rates of tax imposed by the various State Governments and the divergent procedure followed by them in exercising control have long been causing serious difficulties and have been adversely affecting the industry. The stringent controls on some

of those preparations exercised by some of the State Governments to enforce their Prohibition policies, have also considerably complicated the matter.

The Government of India constituted a Committee in 1950 to report on the measures necessary to ensure that such preparations are sold everywhere as far as possible at the same price and for eliminating the difficulties in the flow of products from one State to another owing to diversities in rules regarding transportation and rates on duty.

The report submitted by this Committee sometime back has only been recently published in a summary form. The Committee are reported to have recommended the fixation of uniform rates of duty on medicinal and toilet preparations containing alcohol. The Taxation Enquiry Commission will, no doubt, be supplied with copies of this Report.

The attention of the Committee has, in this connection, been drawn to a Press Report that the various State Governments, to whom the recommendations of the Committee were circulated by the Central Government in July 1952, have already implemented the following interim recommendations of the Committee :—

- (1) A uniform rate of excise duty of Rs. 5/- per proof gallon should be levied by all the State Governments on purely medicinal preparations which are not capable on use as alcoholic beverages;
- (2) A uniform rate of excise duty of Rs. 17/8/- per proof gallon should be charged by all the State Governments on
 - (a) medicinal preparations capable of being used as alcoholic beverages, and
 - (b) toilet preparations.

The Committee have, on the other hand, been informed that this Press Report is not entirely correct. It has, for instance, been stated that the rates of duties for quasi-medicinal preparations (i.e., medicines which can be used for purposes other than medicinal) are still different in different States, as will be evident from Table III appended to this memorandum.

Attention has, in this connection, been also drawn to the fact that every State has a list of quasi-medicinal preparations of its own. This facilitates smuggling from the cheaper source, resulting in the loss of revenue to the State Governments, apart from causing hindrance to the free flow of goods from one part of the country to the other. It has, in this connection, been complained that, in the name of Prohibition, various obstacles on flimsy grounds are being put by officials in the "Prohibition States", thereby retarding the sales of spirituous medicines and other preparations.

It appears from the summary Report of the Enquiry Committee, as published in the Press that, in order to achieve further uniformity in rates, the Enquiry Committee have urged that common lists of restricted and unrestricted preparations should be prepared so that the same preparation is subject to uniform rates of duty in different States, subject, however, to the maximum duty of Rs. 17/8/- per proof gallon, leviable on such preparations.

The question as to how far these recommendations and the actions proposed to be taken thereon by the Government will meet the situation will have to be carefully considered.

Mention may, in this connection, be made of the entry No. 84 in the Union List of subjects in the Constitution of India and Article 268, according to which excise duties on medicinal and toilet preparations containing alcohol, opium, Indian hemp and other narcotic drugs and narcotics to be levied by the Central Government, but collected by the States within which such duties are leviable and appropriated by the latter.

No action appears to have been taken to implement this mandatory provision of the Constitution.

(ii) The Committee are of opinion that, at a time when the Government require additional funds for financing their development schemes, it is not proper that an important source of revenue like excise duty on alcoholic liquors should be relinquished by the various States. It has been reported that the policy of Prohibition which has been in operation in certain States has led to much illicit traffic in liquors. It is not evidently possible for the Committee to state as to how far this report is true. But they would point out that to the extent illicit traffic in liquors has been encouraged, the primary objects of the respective Governments have been nullified simultaneously with the relinquishment of considerable revenue on this account.

The Committee are not aware as to how far, in view of Article 47 of the Constitution of India, it would be possible for any State to reverse the Prohibition policy already initiated by them. But they would like to impress on the Taxation Enquiry Commission the need for cautioning the other States, which have not so far

adopted such a policy, against the financial difficulties that may arise as a result of Prohibition.

(b) As already stated above, excise duties on medicinal and toilet preparations containing alcohol have not so far been levied by the Centre, and the question of co-ordination between the levy of such Central excises and of State excise on alcoholic liquors does not arise.

The Committee would, however, draw attention to the fact, already stated by them, that the stringent controls on some of these medicinal and toilet preparations containing alcohol exercised by some of the State Governments to enforce their Prohibition policies have imposed considerable difficulties on the concerned industries. As an instance, they would draw attention to recent order issued by the Government of Bombay permitting the mass felling of Mowra trees in the State.

The principal oils used by the Soap Industry are coconut oil, groundnut oil, palm oil and mowra oil. In view, however, of the comparative scarcity of coconut oil and groundnut oil, which are also used for human consumption, the Government of India have themselves recognised the need for plantation of mowra trees on a mass scale in order that edible oils may be released for human consumption as far as possible. The Committee also understand that, in pursuance of this policy, some of the State Governments had included mowra trees amongst species recommended for planting on the occasion of the Vana Mohotsava Celebration. Unfortunately, however, the Government of Bombay have recently issued orders for mass felling of mowra trees in the State in order to prevent the flowers from being used for illicit distillation, and they are reported to have adopted a plan of cutting down trees during the course of the year. This action of the Government of Bombay have naturally accentuated the shortage of vegetable oils already caused by a short crop of groundnut oil referred to above, and the prices of all vegetable oils are naturally likely to be affected by a large concentrated demand from a number of industries on a limited supply of same.

General

Question 136

Section 23 of the Sea Customs Act empowers the Central Government to exempt from time to time, by Notification in the Gazette, any goods imported into or exported from India, or into or from any specific port therein from the whole or any part of the customs duties leviable on such goods. According to Section 12 of the Central Excise and Salt Act, 1944, any of the provisions of the Sea Customs Act relating *inter alia* to the levy of or an exemption from customs duties may be applied by the Central Government for the purpose of the imposition of Central excise duties. Further, Section 4A of the Indian Tariff Act, 1934, empowers the Central Government to levy export duty on any article or increase the existing duties, if they are satisfied that such an action should be taken.

As regards import duty, attention may be drawn to the amendment, which was made in March 1951, of the Indian Tariff Act 1934 inserting a new Section 3A empowering the Central Government to levy protective duties on any goods imported into India in respect of which a recommendation has been made by the Tariff Board. As far as the Committee have been able to ascertain, this new Section was not renewed after its expiry in March last.

The Committee are of opinion that the powers now exercised by the Government of India for levying, increasing, reducing or withdrawing the export and excise duties on any particular commodities should remain, in order that suitable action may be taken immediately the internal conditions about production or international situation in regard to the exported articles change. As they have, however, already suggested, this power should be exercised by the Government with due care and attention and after taking into consideration all relevant facts. It is necessary for this purpose to set up a suitable machinery to watch over the condition of particular trade and industry in so far as they are affected by conditions either internal or external.

In so far as import duties are concerned, while the Government have powers conferred by the Sea Customs Act to exempt any article either wholly or partly from the payment of the duty, the power to levy or increase import duties should be exercised only on the recommendation of the Tariff Commission. Such extraordinary powers are necessary in order that an industry may not have to suffer serious losses due to the delay in taking action, the desirability of which has been already examined and endorsed by an expert body like the Tariff Commission.

Question 137

Subject to the observations made in reply to Question 124, the Committee would answer this question in negative.

Question 138

The Committee agree, in principle, to the taxation of "luxury" articles at specially high rates. But they have no suggestion to offer in regard to the particular articles which may be so taxed.

ANNEXURE I.

IMPORT DUTIES ON RAW MATERIALS

Question 104(ii)

(a) Import duty on Lactic Casein

The Plywood Industry has been suffering considerable difficulties on account of high import duty on casein, one of its essential raw materials next in importance only to timber. The import duty on casein is charged at the rate of 30 per cent. *ad valorem* (plus 5 per cent. surcharge) which, at the existing level of C. I. F. prices of the imported stuff, works out at Rs. 450—Rs. 500 per ton and is proving too heavy for the Industry to bear.

Import duty on casein is being assessed under I.C.T. Item No. 87 "all other articles not otherwise specified". Assessment under this item might have been justified at the time when import of casein was on a very small scale. But not that casein is being imported on a large scale for use by the well-developed local plywood industry, it is desirable that casein should be separately classified and assessed at a low rate of duty, not exceeding 15 per cent. *ad valorem*.

(b) Import duty on Soda Ash

The Glass Industry, of which Soda Ash is one of the most important raw material is experiencing serious maladjustment between the cost of production and selling price resulting in huge losses to the individual factories. While the cost has increased by about 300 per cent. on an average as compared to 1938, the selling price has risen by not more than 100 per cent. This rise in the cost is stated to have been caused by a great rise in the prices of raw materials, particularly of Soda Ash. The price of the latter has risen from Rs. 130 per ton in 1938 to about Rs. 375 (imported) and Rs. 446/4/- (indigenous), the current market price. On the other hand, the industry is facing increasing buyers' resistance both within the country and overseas, and stocks are accumulating. In fact, the cost of production of glassware in other foreign countries being much lower, the Indian product are being priced out in overseas markets. If, therefore, the Industry is to retain its market, steps should be taken to bring down prices of Soda Ash. To this end, the Committee would suggest that the Customs Duty of imported Soda Ash should be refunded or at least substantially reduced, as was done in the early thirties. This would not adversely affect the interest of the indigenous Soda Ash Industry, provided simultaneously the following measures are also adopted :—

- (i) There should be quantitative regulation of imports of Soda Ash to cover only the shortfall in indigenous supply.
- (ii) The import of light Soda Ash which only is manufactured in this country should be totally banned and the import of only heavy Soda Ash should be allowed subject to condition (i) above.
- (iii) Consumers of Soda Ash who have not to undergo any technical difficulty in utilising indigenous light Soda Ash should not be allowed to have any quota of imported heavy Soda Ash.
- (iv) Those consumers, who generally require heavy Soda Ash, should be asked to consume a token quantum of indigenous light Soda Ash also, consistently with technical suitability, operational efficiency and economy of production.

(c) Import duty on Borax

The indigenous Enamel Industry is greatly handicapped in developing export market on account of heavy duty on imported chemicals used in the manufacture of enamelwares and the consequent rise in its cost of production compared to that of its competitors in other countries. The import duty on Borax an important chemical used in the industry, is for instance 25 per cent. and constitutes about 40 per cent. of the total cost of the enamels and 20 per cent. of the total cost of the raw materials, including steel, used in the manufacture of domestic enamelwares. On the other hand, the Enamelware Industry in Japan has not to pay any duty at all on imported black sheets for the Enamel Industry. Besides, its labour cost is also less. Naturally the Industry in Japan with its lower cost of production is capturing the overseas market at the expenses of the Indian Industry have further been accentuated on account of limited imports (15 per cent. of past imports) on Borax being allowed direct from the U.S.A. which has practically the world monopoly of the commodity. As a result of the ban, crude Borax purchased from the U.S.A. or other sources is being imported into

Britain and exported therefrom, after being refined, to other countries including India, which has naturally caused a very high increase in the cost of Borax. This high initial cost is again further increased as a result of the high rate of import duty referred to above. The Enamel Industry in Japan has not, however, to suffer a similar handicap as it can import Borax direct from U.S.A. at cheaper rates.

The Committee feel that there is a strong case for allowing a drawback of customs duty on imported chemicals, particularly Borax, used by the Enamelware Industry. In this connection, they would also like to invite attention to the recommendations which had been made in 1945-46 by Sri Nagarwalla, the then Collector of Customs, Calcutta, who had at the time investigated the matter under directions of the Ministry of Finance, to allow drawback of customs duty on imported chemicals used in the Enamelware Industry.

(d) Import duty on Alloy Steel

At present there is a protective duty on Alloy Tool Steel of 31½ per cent. *ad valorem* in case of British manufacture and 44½/10 per cent *ad valorem* in case of imports from other countries, even though the article is not yet manufactured in India and the manufacturers of small tools have to depend entirely on imports from abroad. The action of the Government of India (as per their notification No. 170-Customs, dated the 17th December 1949), in reducing the duty on certain categories of alloy steel, *viz.*, bright drawn and polished drill rods presumably with a view to give relief to the small tools industry has not actually been of any benefit to the small tools industry, as bright drawn and polished drill rods are never used by the industry.

The types of steel which are used in the manufacture of small tools are either black rolled bars or centre-less ground bars. If, on the other hand, bright drawn and finished bars are to be used for manufacture of small tools, they will have to be heat-treated involving losses on account of the consequent conversion of such bars, which are high priced ones, into black rolled bars or centre-less bars which are low priced ones, not to speak of unnecessary labour and expenses for such heat-treatment. Besides, bright drawn bars as a rule are not manufactured over ½" diameter while for manufacture of small tools bars of as much as 6" to 8" diameter are required.

It is, therefore, necessary that the import duty on alloy steel irrespective of the types, should be reduced to a sufficiently low level so as to give relief to the indigenous small tools industry.

(e) Import duty on Carbon Black

Carbon Black, which is an essential raw material for all kinds of rubber products is subjected to an import duty of 31½ per cent. By a notification issued in February '51, however, the Government of India have permitted the manufacturers of rubber tyre to import the article duty-free. While this is undoubtedly a step in the right direction, there is no reason why the benefit should not be extended to the manufacture of other kinds of rubber products as well.

(f) Import duty on Fatty Acid and Hardened Fatty Acid

While there is no duty on tallow, a raw material for the Soap Industry fatty acid and hardened fatty acid which are used as tallow by the Industry (mainly in areas where there is a prejudice against the use of animal fats) have been subjected to a duty of 31½ per cent. *ad valorem* under I.C.T. Item No. 87, thus unnecessarily raising the cost of soaps. As a result, the over-all interests of the industry as also of the consumers who have prejudice against the use of soaps containing tallow with animal fats have been adversely affected. The Committee would, therefore, suggest that the import of Fatty Acid and Hardened Fatty Acid should, like tallow, be duty-free.

(g) Import duty on Gas-filled Cylinders.

While there is no import duty on gas (a raw material for the Lamp Industry) as such, the Cylinders in which this gas is filled is, if new, subjected to an import duty of 31½ per cent. under I.C.T. Item No. 63(28). It has been represented by the Lamp Industry that the imposition of this high import duty on gas-filled new cylinders raises the cost of gas and ultimately, of the finished products. To avoid payment of this high import duty, M/s. Oxygen and Acetylene and Co., Ltd., who import gas on behalf of the Lamp Industry, are getting supplies of gases under the Cylinder Circulation System. Upon import, the Cylinders containing gases are stored in the factories of the Company and distributed to the consumers as and when required, and when the Cylinders are empty they are returned to the Company, who despatch them in batches to the suppliers overseas for refilling and return. As the Cylinders, which are imported within one year of export from India, are allowed duty-free entry, importation of

gas under this system is undoubtedly more economical than importation of gas in new Cylinders. Such importation is nevertheless costly as it involves unnecessary expenditure on account of freight, insurance, etc. on the outward despatch of the empty Cylinders from India, and also delays supply, apart from unnecessarily blocking a large number of Cylinders in the country. It has, therefore, been suggested that new Cylinders filled with gas should be allowed to be imported duty-free or, at least, on payment of an import duty of 5½ per cent. *ad valorem* under I.C.T. Item No. 72(3), to which new Cylinders, if imported empty, are subjected. This would give some welcome relief to the harassed Lamp Industry.

(h) Import duty on Methyl and Iso Propyl Alcohols

As has been stated in reply to Question No. 103, Methyl and Iso Propyl alcohols are non-edible spirits required generally for industrial purposes, but they are classified as Spirits (other than denatured spirits) under item No. 22(4) of the Indian Customs Tariff and the duty is levied at exorbitant rates as for potable spirits. This is not justified. The item should be classified as "Chemical" under Item No. 28 and the duty levied as such. This was also recommended by the Excise Expert Committee, which was appointed by the Government in 1950 to consider matters relating to excise duty on spirituous preparations.

(i) Import duty on raw materials for the Perfumery Industry

As has been stated in reply to Question No. 103, some of the raw materials for the Perfumery industry, such as Resinoids Patchouly leaves, Rose Flowers, Dried, Ambergris, Absolutes, Concrete, etc., are at present classified under "Perfumery" I.C.T. Item No. 31(5) and assessed to a duty at the rate of 62½ per cent., even though they are industrial raw materials and not perfumery as such. The imposition of this high rate of duty on this raw material is not justified, as this is leading to rise in the cost of indigenous production of perfumery goods to a considerable extent.

(j) Import duty on Beech Wood for Card Staves

While Beech Wood is allowed to be imported duty-free for its use in the manufacture of bobbins and shuttles, it is assessed at the rate of 31½ per cent *ad valorem* if used in the manufacture of Card Staves, which are as much an essential wooden store for the textile industry as the other two items. It has been represented that, as a result of the duty, cost of the indigenous industry manufacturing wooden staves has gone high compared to that of the foreign suppliers, and the indigenous products, as a result, are being priced out of the market. The Committee would, therefore suggest that the import duty on Beech Wood for manufacture of Card Staves should be waived.

(k) Import duty on Coconut Oil

The import duty on Coconut Oil, the basic raw material of the Soap Industry, was reduced in November 1951 from 43½ per cent *ad valorem* to 31½ per cent *ad valorem* (standard) and from 31½ per cent to 21 per cent, preferential. It has, however, been represented by the Soap Industry that the duty on Coconut Oil is still very high as the cost of the article represents about 60 per cent of the finished products and should be brought down to a reasonable level. Mention may, in this connection, be made of the fact that the import duties on some other raw materials required by the Soap Industry have been considerably reduced; for instance, in May 1953, the standard rate of duty on Palm oil was reduced from 43½ per cent *ad valorem* to 10 per cent, while the preferential rate of duty at 31½ per cent. *ad valorem* on imports from British Colonies was altogether abolished. The Committee would, therefore, suggest as a part of the policy now being followed in respect of import duties on raw materials for the Soap Industry, the duty on Coconut Oil should also be reduced.

(l) Import duty on Natural Essential Oils

The import duty on Natural Essential Oils and Citronella Oil which are at present levied at 31½ per cent. *ad valorem* and 37½ per cent. *ad valorem* respectively should be substantially reduced as these oils are the very basis of important Essential Oil, Aromatic Chemical and Perfumery compound industries.

ANNEXURE II.

EXPORT DUTIES ON CERTAIN COMMODITIES

Question 113

(a) Export duty on Mustard Oil

The export duty on Mustard Oil, which is 0-3-0 per lb. and is equivalent to about 30 per cent of the value of the oil, should be removed. So long Mustard Oil was

mainly exported to Eastern Pakistan, but now-a-days a good number of oil mills have sprung up in Pakistan and the Government of that country is not also encouraging import of Mustard Oil from India. In fact, in the current import licensing policy issued by the Government of Pakistan no provision has been made for import of oil from India. While the Oil Mills Industry does not hope for revival of market in East Pakistan, it is, on the other hand, receiving enquiries from other countries, and even U.K., for supply of Mustard Oil. But the Industry is not in a position to take advantage of the growing demand of Mustard Oil in other countries as Indian prices, because of the export duty, have always been found to be very high by the buyers in comparison to the prices of Swedish and Chinese Oils. Thus, in U.K., Indian Mustard Oil is being quoted at £154-0-0 per ton as against £131-0-0 and £117-0-0 for Swedish and Chinese oils respectively. The Export Duty on Mustard Oil should, therefore, be totally abolished.

(b) Export duty on Castor Oil

The export duty on Castor Oil, which is levied at Rs. 300 per ton, representing about 20 per cent of the value of the goods, should be suitably reduced. At present, Indian Castor Oil is being quoted at 19 cents per lb. c.i.f. U.S.A., as against German and Brazilian oil at 17½ cents and 18 cents respectively. Attention may also be drawn to the fact that the quality of Brazilian oil is much better than that of the Indian oil. While, on account of the existing duty loss of Indian business has not been appreciably felt, it is essential that the duty should be suitably reduced, so that the Indian prices of Castor Oil are maintained as much competitive as possible.

(c) Export duty on Hospital Rubber Sheetings

A duty of 10 per cent. *ad valorem* was imposed in December last on certain rubber sheetings which were so long treated as free goods on the ground that the item, in the opinion of the Customs authorities, came within the category of "cloth", Item No. 6 of the Customs Export Tariff Schedule. Some of the exporters having represented to the Calcutta Customs authorities that, technically speaking, rubber sheetings could, by no means, be termed as "cloth", the latter have allowed the export of rubber insertion sheetings free of duty as an interim measure, but have not yet made any final decision with regard to classification of hospital rubber sheetings and imposition of duty on the same, even though the matter has been pending for quite a long time. The Customs authorities are stated to have asked the parties concerned to make shipment of consignments of hospital rubber sheetings on payment of duty under protest. This has created an uncertain and confusing situation. Shipments are being held up; foreign buyers are cancelling their orders and the exporters are being subjected to heavy financial losses. For the following reasons, the Committee are strongly of opinion that hospital rubber sheetings should be classified as rubber manufactures and not as cloth and, therefore, be exempted from the duty.

According to the definition of "cloth", as given in Item 6 of the Export Tariff Schedule, "cloth" means "cloth of any description manufactured either wholly from cotton or partly from cotton and partly from any other substance and containing not less than 10 per cent of cotton by weight". It follows from the definition that any material to be called "cloth" should primarily be used for the purpose for which cloth is used and should contain at least 10 per cent of cotton by weight as distinguished from other textile fabrics such as silk fabrics, woolen fabrics, etc. Considered in this light, rubber sheetings, be they hospital rubber sheetings or rubber insertion sheetings, can, by no means, be termed as cloth. These sheetings are definitely processed and mainly manufactured from rubber. The textile insertion, which is used for binding raw rubber with other pigments in order to increase the flexibility and strength of the sheetings is negligible in quantity and loses its identity in the finished products. Further, the purpose for which the finished products *viz.*, rubber sheetings are used are totally different from that for which cloth is used. There are also many other articles such as rubber cloth, nitro-cellulose coated binding cloth, rubber hoses, tyre etc. which, though inserted with textiles to some extent during the processing, are not classified as cloth. In fact, the Government of India in the Ministry of Commerce and Industry have classified them as rubber manufactures in their import/export licensing policy. As stated earlier, the Calcutta Customs authorities also were *prima facie* satisfied with the contention that rubber insertion sheetings are in fact rubber manufactures and not cloth and also allowed the export of the same free of duty. In view of this, and in view of the fact that there is hardly any difference between rubber insertion sheetings and hospital rubber sheetings, there is no reason why the latter item should not also be

treated as rubber manufacture and allowed export free of duty.

In the second place, the classification of rubber hospital sheetings as cloth and the consequent imposition of the export duty on the same will make the Indian goods costlier in foreign market and the local exporters will find it impossible to compete with the overseas suppliers such as Japan, the U.K., Germany etc. In fact, already the foreign buyers are meeting their requirements from other supplies on account of India's inability to supply them with goods at competitive prices and at proper time and export of the goods from the Calcutta Port, since the imposition of the duty, is stated to have come to a standstill. Attention may, in this connection, be drawn to the fact that the export market in rubber sheetings in South East Asiatic countries was developed by the Indian exporters after a good deal of sustained efforts and

once these markets are lost to foreign suppliers, it will be very difficult to regain them.

(d) Export duty on Waterproof Cotton Canvas

The export duty on Waterproof Cotton Canvas, which is at present 10 per cent. *ad valorem*, should be totally withdrawn with a view to maintain the export trade. It has been represented that this duty, coupled with a fairly high import duty on the goods in the importing countries, has made the prices of the Indian goods almost prohibitive, and, as a result, goods from other countries, particularly from Japan, is gradually pushing out the Indian-made materials from the markets of Burma, Malaya, Hongkong, Siam, East Africa, and the Middle East. The following comparative c.i.f. prices for Indian and Japan made waterproof cotton canvas goods are illuminating:—

Quality.	Average Indian Prices.		Average Japanese Prices.	
	Rs.	per yard.	Rs.	Per yard.
18 oz. quality	Rs. 4-8	per yard.	Rs. 4-2	Per yard.
16 oz. „	„ 4-4	„ „	„ 3-14	„ „
14 oz. „	„ 3-15	„ „	„ 3-10	„ „
12 oz. „	„ 3-8	„ „	„ 3-2	„ „
10 oz. „	„ 2-15	„ „	„ 2-10	„ „

Attention may be drawn to the fact that whatever quantity is at present being exported consists either of Tarpaulins on which no export duty is charged or of waterproof canvas against outstanding commitments that cannot be repudiated. It is, therefore, suggested that the export duty should be totally abolished so that the indigenous waterproofing industry, which is an infant one, may maintain and develop its overseas markets. Attention may also be drawn to the fact that the classification of "waterproofed Cotton Canvas" as cloth by the Ministry of Finance for the purpose of duty is rather anomalous, as the Ministry of Commerce and Industry had issued a Notification on the 30th August 1952, excluding synthetic waterproof canvas from the category of cloth.

(e) Export duty on Stockinettes or Hosiery Knitted Fabrics in rolls

In 1951 an import duty on 25 per cent. *ad valorem* was charged by the Customs authority on exports of Hosiery knitted fabrics in rolls as the item came, in their opinion, under the category of cloth as defined in the Customs Tariff Schedule. As a result of the duty, however, the cost of Indian hosiery fabrics became higher than that of other competitors, and export of the items to overseas market, namely, to New Zealand and Australia where there is a big demand for the same (estimated at Rs. 2 crores worth of goods annually) virtually came to a standstill. The subsequent reduction in the export duty on cloth (and consequently also on hosiery knitted fabrics in rolls) in January 1953 to 10 per cent has not helped in the revival of the exports of the latter item, as India's prices are still found to be uncompetitive. The Committee have been informed that while the Indian manufacturers are now quoting 5s. 7½d. per lb. of stockinette c.i.f. or Rs. 3-12-0 with a margin of only 5 per cent profit on ex-factory price, the U.K. is offering the goods at 5s. 3½d. per lb. less 2½ per cent. discount to the importer. There is, therefore, not much scope for the export of Indian hosiery goods to these countries unless there is substantial advantage in price. As, however, the indigenous industry has no scope for economy in its cost of production so as to enable it to compete with U.K. industry, and as further there is no duty on export from the U.K., it is necessary that the export duty on the stockinettes should be withdrawn.

Attention may also be drawn in this connection to the fact that the production capacity of the indigenous industry is very much more than the demand, and it is working only 30 per cent of the capacity on 8-hour shift. To the extent export is facilitated by the withdrawal of the duty, the indigenous industry will also be able to utilise much of its idle capacity.

(f) Need for Imposition of Export Duty on Raw Myrobalan from India

Though the Myrobalan Industries in other countries have to import raw Myrobalan from India, which is its only source of supply, the advantage which the Indian Myrobalan Industry has in the raw material cost compared to the foreign counterparts has been more than counter-balanced by certain other factors.

Firstly, there being no export duty on raw Myrobalan from India, the foreign industries have to pay higher price for the raw material only to the extent accounted for by the freight rate. On the other hand, the Indian Industry is also suffering from a disadvantage,

on account of the preferential shipping freight being imposed on export of raw Myrobalan by the Shipping Companies. For instance, the freight on Myrobalan extract from India to the U.K. is 160 sh. per ton of 20 cwt. while that of crushed Myrobalan is only 101s. 6d. per ton of 20 cwt., there being thus a difference of almost 60 sh. per ton.

Secondly, the foreign manufacturers of Myrobalan Extracts have the advantage of disposing of their home-made Extract in liquid form to their tanneries in tank wagons, whereas the indigenous manufacturers have to convert the liquid Extract into either Solid or Powder form and pack the same in triple bags to ensure safe transit, all of which involve heavy cost.

Thirdly, many foreign countries have imposed heavy import duties on Myrobalan Extract ranging from 8 to 25 per cent. from India keeping, at the same time, import of raw Myrobalan free of duty.

Naturally, the cost of Indian Myrobalan extract has become higher than that of foreign-made Myrobalan extract, and the indigenous industry is unable to compete with the foreign manufacturers. The following figures of cost will illustrate this point:

Landed Cost of Indian Solid Myrobalan Extract in U.K.

3-Ton of Raw Material	£31
Manufacturing Cost of 1 ton of Solid Extract (including the cost of packing material and that of transport to the Port)	£11
Steamer freight from India to U.K.	£ 8
Plus Import duty ranging from 8 to 25 per cent	£ 4 to £12½
	£54 to £62½

Cost of Myrobalan Extract manufactured by U.K. Manufacturers

3-Ton of Raw Material	£31
Steamer freight on 3 Tons	£15
Manufacturing cost of 2-ton of Liquid Extract (from 3 tons of raw material) which are equivalent to 1 ton of Solid Myrobalan Extract	£ 5
	£51

As a result, the Indian Industry is finding it practically impossible to compete in the foreign market and is being gradually ousted. This has involved not only unemployment to a large number of labourers, and unnecessary blocking of capital in the Industry but also loss of large amount of foreign exchange to the country. The Committee are, therefore, of opinion that the Commission should consider the advisability of recommending the imposition of an export duty of a suitable amount on Raw Myrobalan from India to give relief to the Industry. This would also incidentally earn some revenues for Exchequer.

It may be argued that the imposition of the export duty will lead to the use of substitute for raw Myrobalan in foreign countries, affecting the export trade of the country thereby for reasons stated below.

The argument does not, however, appear to stand reason.

In the first place, there is no suitable substitute for raw Myrobalan, which is used as mixtures with other tanning materials. The following extracts from the letter which has been received by the Chamber from the F.R.I., Dehra Dun, is illuminating in this respect:

"Myrobalan has no substitute either within the country or outside. It is not suitable for use as a tan by itself, but in mixtures with other tanning materials, it is valuable for its fermentative, acid forming power, which causes satisfactory plumping of the leather. It imparts mellowness to the leather and is one of the chief bloom-yielding materials."

"Chestnut, divi-divi or any synthetic product has not yet come in the forefront as a rival of Myrobalan."

The Central Leather Research Institute has also informed the Chamber that "there is no efficient substitute for raw Myrobalan anywhere in the world". The Institute has further observed that "chestnut extracts cannot replace Myrobalans", and while "Divi-divi can to a certain extent do so, it is a poor substitute for myrobalans".

In the second place, the imposition of the duty on raw Myrobalan will not increase its cost and ultimately of the finished product, by such a percentage, as would lead to a search for a substitute by the foreign manufacturers and consumers.

In the third place, some of the countries, to which Myrobalan Extracts are exported from India, have imposed a duty ranging from 8 to 25 per cent, without at the same time levying any duty on the import of raw Myrobalan with the object of protecting their own industry. No objection can, therefore, be raised by foreign buyers on the imposition of an export duty on raw Myrobalan, and they will also be willing to pay the duty lest their factories should stop working for want of raw Myrobalans.

PART V.—OTHER TAXES (Central and State)

TAXES ON MOTOR AND OTHER VEHICLES

Question 168

The taxes that road transport at present pay may be generally divided into four categories—

Central Taxes.

- (a) Import duties on motor vehicles and components.
- (b) Import duties and excise on petrol and tyres.

State Taxes.

- (a) Tax on motor vehicles, such as the following :—
 - (i) Vehicle tax or registration fee.
 - (ii) Entrance tax on vehicles entering the State.
 - (iii) Tax or cess on goods or passengers carried by road.
 - (iv) Permit and other fees for Buses and Trucks levied at rates that may pertain to the nature of tax.
- (b) Sales tax on motor vehicles components and petrol.

So far as Central taxes are concerned, no question of lack of uniformity arises, but complaints have been made about the high rates of import duties and also excise duties. The Committee, therefore, welcome the recent decision of the Government to lower the existing high rates of duty on motor car components such as are not manufactured within the country. They hope that this, together with the maintenance of the duties at a somewhat higher level on components within the manufacturing programme of the indigenous automobile industry will help in the development of the industry in India at a rapid pace and will enable the users of road transport to secure good cars at a comparatively cheap price from within the country within a reasonable short space of time.

The Committee have already stated in reply to questions 117 and 118 that there is a case for reduction in the excise duty on petrol in order to lower its price.

The more serious complaint of the road operators is, however, directed against :—

- (i) the comparatively high rate of taxes that motor vehicles, either private or commercial, have to pay not only for movement within the territorial jurisdiction of the State in which they are registered but also for movement across the State boundaries, and
- (ii) the lack of uniformity in the assessment, collection and administration of motor vehicle taxation by different States.

But these factors have been affecting inter-States trade and commerce very adversely.

In West Bengal, for instance, the lorry owners have, since 1949, been required to obtain temporary permits from the State Government for crossing the West Bengal border through the G. T. Road, the fees for such permits, with a validity period of one week only, varying from Rs. 3 to Rs. 6 for one trip only according to distance. The Government of West Bengal have, however, recently introduced a system of temporary permits even for movement of lorries up to and within the border through the G. T. Road, the fee for such permits, with a weekly validity, being Rs. 11. The result of this dual imposition of fees is that a lorry having an up and down trip in a week from Calcutta will have to pay Rs. 11 for movement up to the border and another Rs. 3 to Rs. 6 for movement beyond the border. In other words, it will be subject to an annual fee of Rs. 528 up to or within the border and Rs. 672 to Rs. 816 beyond the border, in addition to the road tax of Rs. 450 to Rs. 1,000 according to the weight of the lorries which the lorry-owners have to pay apart from other taxes.

Similarly exorbitant rates are charged by some other States for using particular roads; the rate is Rs. 58-8-0 per day for using Madhya Bharat roads, that for the Bombay-Agra Road traversing Madhya Bharat territories being as much as Rs. 88-8 per day.

Apart from this high tax for use of roads, the road operators and also the industrial concerns located in one particular State, but having markets in other States, experience some difficulties in plying their propaganda and sales vans or goods lorries in the areas owing, among others, to the following restrictions :—

- (i) A van not being allowed to be registered under the Motor Vehicles Act in more than one place.
- (ii) There being no single authority in the States to endorse road permits for the whole State.

To meet all these difficulties, the Committee consider that the ideal system would be to introduce complete uniformity in regard to motor vehicles taxation, and they would certainly prefer a consolidated tax instead of several taxes by different authorities. They are, however, aware of certain difficulties which may be experienced in giving effect to such a proposal, and they would suggest, for consideration of the Commission, that licences for motor vehicles for the goods and for propaganda should be split up in two categories—on Statewise, and on the all-India basis—and the licence fees may be fixed up accordingly, the fee for the all-India licence being uniform throughout India. In such an event, the different States may impose different rates for licence for movement within their own territorial jurisdiction, but would be required to conform to uniform rate in regard to movements between two or more States. The question whether a Central organisation may not be formed for issuing licences on an all-India basis may also be considered in this connection.

As regards the difficulties of the road operators on account of lack of uniformity in regard to sales tax on motor vehicles, a reference may be made to the views expressed, in reply to questions in Part III.

Question 169

As far as the Committee are aware, except for the Central Road Fund, the proceeds from motor vehicles taxation are not at present earmarked for road maintenance and development. While, generally speaking, proceeds of all taxes should be credited to the general revenues, motor vehicles taxation presents a different problem in so far as motor vehicles pay tax not merely as one of the various sectors of the economy but also by way of compensation to the damages caused to the road system as a result of heavy traffic. Besides, the development of roads and their maintenance is one of the most urgent problems which stand in danger of being neglected on the plea of inadequate financial resources of the Government. As a matter of fact, complaints have been freely made by the users of road transport as well as by the operators against the very bad condition of roads. The responsibility for maintaining the roads in a good condition depends upon the Central Government, States Governments, and Local authorities according to the classes to which they belong. But whoever may be responsible, the fact remains that the roads are not being well-maintained, apart from the paucity of the roads as a whole. To the extent the authorities complain of lack of funds for their comparative inactivity in the matter, the Taxation Enquiry Commission should consider how far it is advisable to utilise the proceeds of the various taxes on roads, motor vehicles and parts thereof, and petrol and other oils for purposes, other than the construction and maintenance in goods condition of all-weather roads and bridges. As this matter is also of considerable relevance to the development of the economic resources of the country, the Committee have no doubt that the Enquiry Commission would consider the matter not merely

from the point of view of the road operators, who are undoubtedly most directly affected, but from that of the general well-being of the country.

Question 170

The Committee generally approve of the recommendations of the Motor Vehicles Taxation Enquiry Commission, 1950, and have no specific comments to make on their main recommendations.

Question 171

NO.

Entertainments Tax

Question 172

A. For reasons already mentioned in the Preliminary Memorandum, the Committee consider the incidence of the tax on the Cinema Industry too heavy. They are not in a position to state as to whether the rates have really reached a point of diminishing returns, but they are of opinion that the matter deserves careful examination.

B. The rates of duty at present differ widely from State to State, and there is no doubt that there should be uniformity therein.

The best method of achieving uniformity would undoubtedly be to make the entertainment tax a Central Subject and allotment of the net proceeds to the States according to the principles that may be laid down in this respect by the Finance Commission. The Committee are, however, conscious of the very strong opposition which such a suggestion might evoke from the State Governments, and they would suggest that, in the event centralisation being not possible, the different States should enter into some manner of convention regarding the rates of duty that may be charged by them.

C. As the Committee have already stated in their Preliminary Memorandum, they are strongly against the present system of taxation in so far as it provides for a graduation in the rates. They would, in this connection, invite reference to the fact that the Film Enquiry Committee also had recommended that the entertainment tax should be levied on a uniform scale at the rate of 20 per cent of the gross takings. In such an event, the exhibitors will be free to adjust the prices of the various classes of tickets to their cost and the ability of their clientele to pay admission prices according to their financial condition. The Film Enquiry Committee also expressed the opinion that such a system will not affect the total revenues from entertainment tax and there should not, therefore, be any ground for objections on the part of the State Governments.

Incidentally, the adoption of the suggestion made above will also make it much easier to centralise the entertainment tax.

Question 173

The Committee consider that exemptions may be granted to the following:

- (i) Educational films.
- (ii) Those shows the net proceeds of which are applied to *bona fide* charities such as are recognised by the Income-tax Act. The State Governments may also be given powers in special cases to extend the scope of exemptions to such other charities as may be considered by them to be deserving of such exemptions.
- (iii) The question of exemptions to the lowest class of tickets will not arise in the event of the tax being applied at a flat rate on the entire gross takings.

Question 174

A. The Committee have been informed that the general source of evasion is by unscrupulous parties who use duplicate tickets. They are reported to put entertainment stamps on one set of tickets and keep regular record of same for the purpose of entertainment tax. The other set of tickets is sold surreptitiously without any entertainment stamps being put on them. The only way to check this is to require all exhibitors to use only consecutive numbers on the tickets they sell mentioning the name of the film, the time and date of the show, the price of admission and the entertainment tax payable on the same, the last item not being required in the case of a flat rate of tax on the gross takings. Tickets should be in triplicates, one portion being retained at the ticket office, one portion being collected by the gate-keeper and the last portion re-

maining with the purchaser. Even now the Industry has a system of check over the sale of tickets, and if the Government also carry out surprise checks and co-operate with the authorised representatives of the Industry, this evil practice may be reduced to the minimum, if not removed entirely.

B. Complimentary tickets have to pay entertainment tax and as such their limitation only will not help. Moreover complimentary tickets have to be issued by the Producers or the Distributors of the films to their patrons as a part of salesmanship. At the same time a limit should be prescribed and a ratio of the number of tickets to the total value of sales may be fixed.

Question 175

In West Bengal, Entertainment Taxes are at present levied on any exhibition, performance, amusement, game or sport to which persons are admitted for payment, and the Committee would not recommend any further extension of the scope of application of the Tax.

Tax on Consumption or Sale of Electricity

Question 176

A. The Committee consider the consumption or sale of Electricity as a suitable source of tax which may be adopted by other States. The rate of tax will of course, be subject to local conditions, and cannot be uniform for all States.

B. Sales for industrial uses should be exempted from payment of the tax.

Question 177

(a) Domestic use of electricity other than for lights and fans should not be taxed, for the following reasons. Whereas the use of lights and fans are for a consumer's personal comfort, the use of refrigerators, cookers and radios reflect a general improvement in the nation's economic and social conditions. Refrigerators preserve food and avoid wastage of food. Cookers save precious fuel like coal and oil necessary for other purposes. For years transport of such fuel has been a bottleneck in the railway system. Radio is or should be a very important medium of education. Therefore, these should be exempt from tax.

(b) For domestic consumption in West Bengal, the exemption existing at present is reasonable and no change should be made in it. The only case which would need sympathetic consideration would be newly electrified areas in any State. For the first two years, no duty should be levied.

Question 178

Please refer to answer to Question 176.

Question 179

No modification in the suggestion made above will be necessary if in some cases Government becomes the actual supplier of electricity. Since the duty is a special tax and since the Government would bill a consumer for electricity consumption in the same manner as a licensee does, no modification is necessary. The amount of the tax is shown as a separate item in the bill and the licensee pays this money into Government Treasury under a particular head. The Government would similarly credit the amount of duty to that head and not take it into account when preparing their own account for supply of electrical energy.

Question 180

As already stated above, there cannot be any uniformity as between different States, as far as rates of tax are concerned. The principles of taxation and exemption should, however, be uniform.

PART VI.—LOCAL TAXATION

Question 210

The Committee strongly oppose the levy of octroi and terminal tax as forms of local taxation. They are also strongly opposed to the suggestion that local bodies should be allowed to levy surcharges on sales tax.

Question 221

A theatre tax or Show tax is very much unsuitable as a form of taxation. The action of certain local bodies and States in levying a Theatre Tax has, in effect, really amounted to double taxation of one and the same source. The Film Enquiry Committee which had examined this matter had strongly recommended its abolition, and the Committee hope that the Taxation Enquiry Commission will also endorse the view of the Film Enquiry Committee.

BHARAT CHAMBER OF COMMERCE, CALCUTTA

REPLIES TO THE QUESTIONNAIRE ISSUED BY THE TAXATION ENQUIRY COMMISSION.

PART I.—THE TAX SYSTEM

Question 1.—Objectives and Relative Place of Different Objectives.

The primary purpose of a Tax Policy is necessarily to raise 'adequate' revenues, 'adequate' for meeting an accepted level of Governmental expenditure. But the different taxes are bound to have effect on the economy, besides bringing in the revenue, and therefore adjustments have to be made between the revenue objective of the tax policy and other objectives. The enlightened business community recognise the new perspective of taxation, but it appears that the real controversy as to extra-revenue purposes of taxation lies in the degree to which one or more of such purposes are sought to be carried out at any particular stage of development. The Chamber is not in favour of looking upon the tax policy as the main lever of economic control.

At the present stage of India's economic development, the emphasis must necessarily be on production of additional wealth and on expansion of employment opportunities. The Chamber therefore feels that at the present stage, among the extra-revenue objectives mentioned by the Commission, the objective of encouraging "incentives to work, to save, and to invest" should be given the highest priority. From among other objectives mentioned by the Commission, the 'maintenance of the external balance of the economy', may be accorded the next place in order of priority. The place that the foreign capital occupies in the economic life of the country, and the roles assigned to fresh foreign capital and foreign trade in the programme of development lend special significance to this objective. The import duties on raw materials and machines, the export duties, and tax measures in respect of foreign incomes of Indians and Indian incomes of foreigners in India have significant effect on the balance of payments position in the country.

While the chamber are at one with the Government in the welfare ideals of the State, it considers that at the present stage of development, the levels of expenditure for realisation of such ideals should be kept in bound in order that the tax system may not cast a prohibitive burden upon the production of wealth which is intended to be achieved on the basis of a 'mixed economy', and in which private enterprise has been assigned heavy responsibilities.

In the opinion of the Chamber, at the present stage much emphasis need not be laid on the utilisation of taxation as instruments for reducing inequality of income or wealth or for using them as measures in dealing with inflationary and deflationary situation. Such non-fiscal purposes may acquire greater importance only at a later stages of development. The Chamber is not aware of any measure of equality or inequality to have been accepted or rejected by the community, or for the matter of that by the Planning Commission or the Government. During the last decade or so such undetermined objectives were rather too much brought in in measures like Excess Profits Tax, Business Profits Tax, Capital Gains Tax, High Income and Corporation Tax, etc. But these along with other measures in the field of labour welfare have adversely affected the economy. A shift of income has taken place from the traditional saver's class to those who were never prone to save. The latter group could not be trained to save either, while diverting income to them. The result has been dearth of saving for capital formation.

The Chamber would like to emphasise that productivity of unit capital in the private sector is much higher than in the public sector and because the private sector is expected to carry the bulk of the responsibility for industrial expansion and for achieving the desired shift in employment from agriculture to industry, the taxing system must be adapted at the present stage to aid business activities especially industrial activities.

The volume of the margin of current income that may be left to individual earner and with different categories of businesses out of their business incomes, largely determine the incentives for work, flow of venture capital, and investments. In the opinion of the Chamber, therefore, at the present primary stage of development when the capital resources are meagre compared to the requirements, larger scope need be provided for individual and corporate savings on voluntary basis and the people, in whatever field of activity, should be left with a greater command over their current incomes for determining their respective levels of expenditure.

As to the modifications needed in the Indian tax system, the Chamber would refer to the replies given in the subsequent questions raised by the Commission. They would however stress even here that to inject greater vigour in the economy the load of direct taxation is required to be slashed substantially. At the present primary stage of development our mixed economy cannot function with the existing load of direct taxes.

Question 2.—Criteria for determining Equity of a Taxing System.

The Chamber does not consider it possible to lay down some absolute criteria for all times for determining the equity of a tax system. The basic criterion to determine the equity of a tax system would naturally be 'social expediency', the contents of which would vary at different stages and phases of the economic conditions of the country and the social ideals set before it. So long as the tax fabric is considered socially expedient it has to be accepted as "equitable". The social expediency criterion is, however, a complex of several other criteria and different criteria would be important for determining the equity of the different taxes in order that the entire tax fabric may be considered expedient from the social and economic standpoints. In the opinion of the Chamber, a tax system may be considered as socially expedient at any particular point of time if it brings "adequate" revenues without causing unbalance between the investment and consumption incentives.

The criteria connected with achievement of non-fiscal purposes can be applied only after certain stages of development. The criteria of 'equal proportional sacrifice' or 'benefits received', etc., cannot have immediate applicability.

At the present stage and phase, the effect of a tax on the economic propensity to risk, venture and invest should be the first criterion to judge the social expediency and therefore, equity of the tax system as a whole *vis-à-vis* the economy. The Chamber would emphasise that equity should mean at the present stage a larger opportunity for investment by a wider number of individuals and corporations. The criterion of wider distribution of income and wealth should be taken to mean wider distribution of the opportunities for investment, for the purpose of creating additional wealth by a larger number of men in the country.

By way of clarification, the Chamber may observe that the new Industries are not allowed sufficient reliefs and incentives even during the initial years, which Pakistan, Egypt, etc., have allowed. In Pakistan the individual investors are also allowed deductions for investments in specified industries. Then again the Income Tax and Super Tax computations are considered inequitable; the Corporation tax puts the smaller companies into difficulties as they have to depend more on share capital than on loan capital to which recourse can be taken by the "Bigger" concerns. The burden on share capital than on loan capital to which recourse very class of the society who have the will to save, and thus their capacity to save is seriously affected. During recent years the Government took away a considerable portion of the Exporters' margins of income by imposing Export Duties. But with the emergence of the recession, and increased international competitions subsidies have not come to the Exporters. These are all considered to be inequitable from the standpoint of business incentives.

The Chamber would also like to mention that one criterion to determine the equity may be to make the tax measures as neutral as possible in their effect on the free flow of trade and industry within the country. Such neutrality criterion is mentioned only for emphasising that the taxes should not be allowed to have restrictive effect on the flow of investments, movement of trade, and the decisions of the individual and business community. By way of illustration, it may be said that Sales Tax in the Bombay State has a discriminatory effect on the export trade, in so far as the Mills have not to pay the tax if they themselves export, whereas dealers have to pay the tax; Sales tax is levied on cotton in Bihar, but the raw material is exempt in other States with the result that the investments in Colton Mills are subjected to discrimination in comparison with the Mills in other States.

Yet another criterion for judging the equity of a particular tax may be the manner in which it affects the 'earning power' of the tax payer. It is to be conceded that the marginal efficiency of capital is higher at upper income brackets and a tax should not unduly affect the power of earning income and consequentially

the power of supporting the established Government. In applying the 'ability to pay' criterion upon the upper bracket individual earners and corporations, it should be carefully considered that the ability to earn is not affected by the impositions. The social expediency principle seems to justify the adoption of such criterion at the present stage of the country's development.

By widening the orbit of indirect taxes, by reducing the proportion of direct taxes in the revenue, and by relying a little more on non-tax revenues on the lines indicated in the course of replies to other Questions, may improve the system so far as equity is concerned.

Question 3.—"Ability to Pay" Principle in Indian Tax System.

There is no easy calculus for measuring the ability of the individuals and the Corporate Bodies in bearing the Governmental imposts. The principle of equity requires that the burden of public charges should be distributed among the different classes and individuals in such a manner that each one can be made to contribute according to his respective tax bearing capacities. Such tax bearing capacities are to be measured in relation to income, expenses required for an accepted standard of living of the earner and his dependents, the scope for providing a reasonable amount of social security for the future, and incentives for saving and investment. In respect of direct taxes, therefore, the question of appropriate graduation of incomes, and refinements for expenses, savings and investment, are required to be made. The burdens, both of direct and indirect taxes, have also to be taken into consideration in measuring the ability at each level of income and the rate of progression in matters of taxation has to be adjusted with reference to the need for leaving a fair portion of the income with the earner for further investment.

It is felt that the ability-to-pay principle has not been properly used in the Indian tax system. Firstly, the direct taxes are made now to contribute 40 per cent. of the revenues and these are to be borne by a microscopic minority of the population. Such reliance on direct taxes on such a narrow base has resulted in compromising the ability to pay principle with increased revenue needs. In respect of Income-tax other than Corporation tax, the rate of progression has been too steep at the upper income brackets and the size of the money income itself is taken as almost the only measure of the ability to pay without adequately providing for the expenses either for the individual or for the company on the lines of countries like the U.S.A., U.K., Australia, Canada, etc. In the Corporation tax again, there is inadequate recognition of the ability to pay principle in so far as the Corporation tax operates on Corporate Bodies even if they earn less than such amounts which are exempted for Individuals and Hindu Undivided Families. In property taxation, the *bond fide* rental value of the property is taxed without adequate consideration of the changes in the expenditure to be incurred in the maintaining the property or in collecting that income. Even the Municipal Taxes are not fully allowed.

The major burden of the indirect taxes also fall on the very same groups of persons who bear the incidence of the high rates of income-tax.

In the opinion of the Chamber, it is possible to secure a better application of the ability to pay principle, by spreading the population coverage of indirect taxes so as to yield more revenue and re-adjusting the income-tax structure. It has been estimated that at present some 12 per cent. of the people contribute some 86 per cent. of the tax revenues, and it cannot be said that 88 per cent. of the population has ability to contribute only 14 per cent. of the Governmental charges. These 88 per cent. has to be touched through indirect taxes to contribute more and to that extent the load on the balance of 12 per cent. of the population needs be lowered to bring the tax draft within their tax bearing capacities. For this latter purpose the progression in income-tax and super-tax rates require substantial modification, and in assessment of the income earners adequate consideration is required to be given to the personal allowances, which are allowed under all modern tax systems. The application of the maximum rate of income-tax at Rs. 15,000 level and that without due personal allowances is a poor recognition of the ability to pay principle. The exact re-adjustments which the Chamber may suggest are indicated in reply to questions in Part II and under Q. No. 66.

Question 4.—Use of the Taxable Capacity of Different Sections of the Community in the Indian Tax System.

There is no absolute definition or measure of taxable capacity of a society or an Individual. It may be described for a mixed economy as the capacity to bear the burden of imposts by the Governments and other Public Authorities without undue interference with productive activity and the functioning of a dynamic economy. Taxable capacity changes with volume of National In-

come, pattern of public expenditure and the people's psychology.

In the opinion of the Chamber, the taxable capacity of the various sections of the Community, has not been properly utilised under the Indian tax system. For example, the Income tax in India is virtually an urban tax and is paid by some 25 per cent. of the country's population, and some 4.25 per cent. of the urban people who constitute some 17 per cent. of the population of the country. It has been estimated that 88 per cent. of the population earn less than Rs. 2,000 a year each and they contribute only some 14 per cent. of the tax revenues, while some 12 per cent. of the people have to bear the burden of 86 per cent. of the tax revenues. It is, however, felt that because of the low per capita income, it may not be feasible or economical to bring the people in the lower income brackets and specially those living in the rural areas, within the orbit of the direct tax. Their tax bearing capacities are to be tapped only through indirect taxes. It should be seen however, that men with comparable incomes in the rural and urban areas are not differently taxed. At the present moment, people living in rural areas and earning their incomes from sources like Agriculture, Forests, Fisheries, Orchards, Poultry, etc., are probably paying much less to the coffers of the Governments than those who are earning from sources like salaries, business, trades and professions, etc., in the urban areas. An average agriculturist or a village craftsman bears much lower burden of tax than his counterpart in an urban area. A land holder pays in the aggregate less to the Government than his comparable counterpart in non-agricultural occupation subjected to Income-tax. The smaller Corporate Bodies are crippled by Corporation Tax and therefore the burden on them should be taken to have exceeded their taxable capacity. The load of per capita Indirect Taxes on the 'richer' section is stated to be Rs. 56-3-0 whereas it is Rs. 2-8-0 per year on the "poor". The impact of the majority of the States Taxes falls on the assesseees in the urban areas. The Report of the National Sample Survey indicates that in a total per capita expenditure of Rs. 220 in rural areas only Rs. 1-25 is paid by way of land rent and taxes as compared to Rs. 15-8 spent on ceremonial functions. Land Revenue and agricultural income-tax constitute less than 10 per cent. of the total revenues of the Central and State Governments. Of the excise duties on mill-made cloth, sugar, coal and of import and excise duties on tobacco, betelnuts, etc., very little fall on rural population; because only 10 per cent. is spent on clothing, 3 per cent. on betelnuts and tobacco and practically nothing on sugar. The burden of import and excise duties on Kerosene and Matches is also very small as only 3 per cent. of the expenditure is on light and fuel combined. On the other hand agricultural prices have continued to be high for many years, and a shift in income has taken place towards lower income groups. So, it appears that there is some layer of taxable capacity in rural areas and lower income groups generally.

Question 5.—Proportion of Tax Revenue to National Income in India.

It is true that in India the proportion of tax revenue to national income is low in comparison with certain other countries, but it should be considered that such proportion of taxes to national income does not indicate the burden on those who pay the tax nor do they indicate the effect of taxation on incentives to work, savings and investment in the country. The low proportion only indicates the low taxable capacity of the country. The per capita income converted in dollars will show that while it was only 57 in India in 1949-50, it was 773 in Great Britain, 1453 in the U.S.A., 856 in New Zealand, 870 in Canada, 67 in Ceylon. Secondly, the population coverage of income-tax in India is 25 per cent., as against 44 per cent. in the U.K., 37 per cent. in the U.S.A., 34 per cent., in Australia, 20 per cent. in Canada and the narrow coverage proves that the low proportion of tax revenue to National Income does not mean lower burden on the tax payer in India. Then again, in Argentine which is also a predominantly agricultural country like India, income-tax rises to a maximum of 27 per cent., whereas in India it rose in 1947-48 to 92 per cent. at an income level of Rs. 10 lakhs and stands at roughly 78 per cent. now. In Japan the maximum percentage of income-tax is 55. The present level of direct tax in India has crossed the taxable bearing capacity of the assesseees. Some increase in revenue is possible from indirect taxes if suitably adjusted and extended. But this will be offset by the imperative decline in direct taxes.

At the present level of per capita income and in consideration of the meagreness of investment capital, the Chamber does not consider it feasible to increase the proportion of tax revenue to the national income in the near future. If the country is to be developed, on the basis of a mixed economy, it would not be advisable to attempt for increasing this proportion. As far as the Chamber is able to understand, the Planning Commission also do not envisage any increase in this proportion during the initial stages of development.

Question 6.—Relative Place of Direct and Indirect Taxes.

Till the per capita national income increases so as to warrant the inclusion of a larger number of income earners within the orbit of direct taxes, indirect taxes are bound to continue as the sheet anchor of the country's taxation system. In view of the low per capita income in the country, widening of the base for the direct taxes among a larger number of population may not be feasible and economical. To impose a large draft on the profits of a few corporate organisations and on less than a quarter per cent. of the population's income, cannot also produce the desirable yield while unduly undermining their income earning capacity. The Committee feel that the ideology of relying more on direct taxes or at least to secure a 50:50 ratio is not feasible in India now. Eagerness to go in for what may be termed as "equalising taxation" at this stage means further contraction in the coverage of direct taxes. In the revenues of the Central and State Governments combined, while the share of taxes on income constituted only 9.6 per cent. in 1937-38, it was raised upto 35.8 per cent. in 1944-45 and was more than 20 per cent. in 1952-53. The share of Corporation tax in the Central Government revenue was only 2.2 per cent. in 1937-38, and it went upto nearly 25 per cent. in 1944-45 and still it stands at a little more than 10 per cent.; while the share of the Customs declined from nearly 50 per cent. of the Central revenues in 1937-38 to a little over 40 per cent. in 1952-53. The Chamber considers that at the present stage of development, the proportion of indirect taxes should be much higher than that of the direct taxes. The proportion of indirect taxes at a level of 75 or 80 per cent. of the revenues may be considered reasonable for many years to come.

In this connection, it may be mentioned that in Canada, the share of indirect tax was 74 per cent. of the total revenues in 1928 as compared to the share of direct personal taxes of 6.4 per cent. and of direct corporation taxes of 4.9 per cent., and in that year the per capita national income of that country, after payment of all taxes was \$464 as compared to the present per capita national income of India of only \$ 57. Indirect taxes in the U.S.A. was also very high during the developmental stages of 1890's. Even now, in most of the foreign countries, the tendency in local taxation is to realise more and more from indirect taxes than on direct taxes, even though such local Bodies have powers to impose direct taxes. In the U.K. under the Socialistic Labour Government also, the proportion of Indirect taxes was increased from 41 per cent. of 1928-29 and 44 per cent. of 1938-39 to 46 per cent. in 1948-49.

Question 7.—Non-tax Revenues.

In the opinion of the Chamber, non-tax revenues should increase in future. A large portion of the investible capital of the Society is being invested in public undertakings and therefore, the incomes from these should be relied on by the Government as a source of revenue. The contributions from Railways, Posts and Telegraphs, State Governments' Road Transport Organisations, and other States' commercial undertakings, levies from irrigation projects, etc., should provide the Government with larger revenues. Under the Five Year Plan, roughly 60 per cent. of the current savings of the society are being diverted to the public sector and therefore it should be considered reasonable to expect that such undertakings should be able to contribute larger amounts to the revenues of the State. (An estimate of the return which should be available from Public Commercial Undertakings may be made on the basis of a return of 6 per cent. of investments in the Public Undertakings of a Commercial nature, after provisions for income-tax applicable on comparable undertakings in the Private Sector and without unduly charging for the goods supplied or the services rendered.)

The Chamber would also like to emphasise that among the non-tax revenues of the State, draft on labour and services of individuals should be also considered as desirable sources of indirect revenue. It appears that it may not be possible to develop the country's economy at the desired pace without such draft on individual labour and service. Too much reliance on monetary expenditure for development calls for larger revenues and the base for raising such revenue is found too slender for the purpose, and therefore, the development gets impeded. This vicious circle can be partially met if greater reliance is placed on service revenues. By such drafts on labour and service a considerable portion of the estimated expenditures on rural developments and welfare measures can be saved, and this saving may be considered as Service Revenues. The Planning Commission also seem to have some such idea and it is reported to have been partially introduced in the Community Projects. (Vide Para. 34 of the Report.)

Questions 8 and 9.—Funding or Ear-marking of Taxes and Levy of Cess.

In the opinion of the Chamber, funding or ear-marking of the receipts of particular taxes for specific pur-

poses is not desirable as a general rule. Such finding or earmarking if carried beyond a very restricted limit (if at all) brings undesirable rigidity in the Public Finance.

In the exceptional circumstances of India, when rapid developments are desired and public funds are slender, Imposition of Cess may be necessary and desirable. But in its incidence a Cess must conform to the "benefits received" criterion of equity. The Chamber is therefore strongly opposed to the policy of the Government to levy cess on one industry to subsidise another industry, as has recently been done in the form of a Cess on mill-made cloth to raise some Rs. 6 crores for subsidising Handloom Industry. This is inequitable in principle and in this particular instance is against the interest of the common consumers of cloth in India. A Cess in a region or on a particular industry can be levied only for the benefit of the local people or that particular industry who bear the burden of the levy.

Question 10.—Extension of State Undertaking *vis-a-vis* Revenue.

It can generally be said that the revenues from the commercial undertakings and State domains have been discouraging so long and the productivity of capital in the State undertakings has been found to be lower than that in the private sector. The revenues from the proceeds of agricultural products, forests, subsidised companies, irrigation, etc., were Rs. 27.32 lakhs in 1924-25, Rs. 19.05 lakhs in 1936-37, Rs. 125.72 lakhs in 1944-45, Rs. 143.8 lakhs in 1946-47, in Undivided Bengal. As compared to these, the revenues from all such undertakings in West Bengal were Rs. 44.3 lakhs in 1950-51, Rs. 37.6 lakhs in 1951-52, and 1952-53, though the West Bengal Government went in for undertaking profitable lines of commercial activity like the Road Transport. While the private Road Transport Services were making considerable profits, the State Transport Organisation of some State Governments exhibited net losses to the extent that operational expense per vehicle has been higher than the gross receipts per vehicle.

In regard to pricing, the Chamber would like to mention that the freight rates in some State Transport Service have been higher than those in the private services. Where there are vital State monopolies like Forests, the prices have been high with the result that the consuming industries have suffered. Where such high prices are charged by the State monopolies, whether these are Railways or Postal services or the Telephones, or the Forests, there is an element of taxation in such prices in so far as these services can be rendered by private undertakings at cheaper costs. The prices of State Undertakings should be comparable to those that may be charged by a Private Enterprise without monopoly advantage. If such a price policy is followed then unless there is inefficiency there should be surplus except in those cases where the State may undertake the enterprise because Private Capital considers it "unremunerative". The Chamber would, therefore, suggest that except those already undertaken by the Governments under the Five Year Plan, there should be no further extension of State undertakings. The Governments should also withdraw from some undertakings like Road Transport. Such withdrawals may bring more income to the Governments by way taxes and would also help employment.

Question 11.—Surplus earned by State Undertakings *vis-a-vis* General Revenues.

State Undertakings should be managed by autonomous Corporations and these should bear their share of the rates and taxes at par with the private undertakings of comparable sizes and types. Thereafter, the net surplus may be apportioned between the respective Governments and Corporations themselves. In cases of State monopolies, a portion of the net surplus after payment of the rates and taxes at standard rates, may be also allocated to a separate fund for financing development projects. The Chamber would like to mention in this connection that the U. K. public industries like the private, have to bear their share of the rates and taxes and the nationalised industries in the U.K. were brought within the scope of the profits tax by the Finance Act of 1947. Payments have also to be made by the nationalised industries to the local Governments in lieu of the rates in terms of the provisions of the local Government Act of 1948.

Question 12.—Basis of differentiation for measuring the incidence.

In the opinion of the Chamber, neither income nor occupation nor residence can singly be taken as a basis for division of the people into classes for the purpose of examining the incidence of taxation. All the three factors have to be taken into consideration.

Regarding income, a differentiation may be made between the comparative ease with which the income is earned. For example, incomes earned under salaries or by carrying on a business, trade or profession, are earned with greater exertion than the incomes from inherited properties. The degree of risk involved in

earning income as also sources of income are factors that deserve consideration. With respect to direct tax, while differentiating on the basis of income adequate consideration need be given to the average size of the family and the number of dependents in the different income Groups as also the residence (rural or urban) of the family where the income is to be spent for living.

It is generally felt that the incidence of tax on middle-class people living in the urban areas and engaged in occupations like service, independent trade or profession, is very high at the present, while this very class has been the traditional savers. In examining the incidence on such classes of people or on any other class, the standard of living and the pattern of consumption should also be taken into consideration along with the number of dependents in such families.

On another basis also a differentiation may be made for examining incidence of taxation. In India family constituted the unit of production in the past and even now, Hindu Undivided Family is an institution characteristic of the Indian Society. The incidence of the tax system on the institution of joint family may be specially examined, and the Chamber's views in this regard are indicated subsequently under Question No. 70.

Question 13.—Opinion as to the Burden of the Present Tax System on various Classes and in Different States.

As was observed in the preliminary Memorandum of the Chamber, the first impact of the various taxes, seems to be more important than the possible ultimate incidence and therefore the word "burden" is to be taken to signify the first impact of the various taxes. An appraisal of the impact of the various taxes is also important because it directly influences the decisions for consumption, savings, incentives to work, incentives for risk taking and undertaking business ventures. The direct impact of the various taxes also influences the volume of the venture capital that may be required for undertaking business activities. For example, Rs. 142 crores of Import duties were realised during 1951-52 and a few hundred of Importers had to bear the burden and the risk of this additional amount, as they had to make the payment at the time of clearing the goods; the process of shifting the burden was a complex of many factors.

(a) The income tax is paid by about a quarter of one per cent. of the working population of the country. The coverage of the Agricultural Income-tax as compared to the total population is also virtually negligible as this tax does not exist at all in the majority of the Part A and Part B States. Then again, the income-tax in India is virtually an urban tax with a steep rate of progression as pointed out elsewhere. As already pointed out above, the burden of most of the Import and Excise Duties are not also borne by the rural people.

In the next place, the Chamber would like to point out that on occupational basis, the people who earn from occupations in Agriculture, Forests, Poultry, Fishery, etc., are taxed very little as compared to those who earn from industry, trade, professions and even from salaries.

In respect of personal Income-tax, the incidence in the middle and upper income brackets is high. The middle and upper group income-tax payers constitute the traditional saver class and those in this bracket also bear the bulk of the burden of the indirect taxes, whether Central, State or Local. It appears that the incidence in these brackets as related to their taxable capacities, is very high.

It may be mentioned in this connection that the population coverage of Income-tax in the U.K. is 44 per cent., in the U.S.A. about 37 per cent., in Australia about 34 per cent. and in Canada roughly 20 per cent. It may also be mentioned that even in the U.S.A. an income of 15,000 has to bear an Income-tax burden of only 4.9 per cent. whereas in India, in 1952, this percentage worked out to 7.6. Similarly for an income of Rs. 50,000, the percentage in U.S.A. was 20.3 in 1952 as compared to 30.9 in India and for an income of Rs. 1 lakh, the respective percentages were 31.6 and 50.1.

The burden of the Corporation tax is also high as compared to the total paid-up capital of the Corporations and therefore those who invest in the shares of the Corporations have to bear a higher burden of tax because of the Corporation tax and the dividend tax, than those who invest in lands or pursuits like Agriculture, Poultry, Fisheries, etc. This applies even to small investors. In a recent study in America, it has been found that 56 per cent. of the investors considered the Corporation tax and a simultaneous dividend tax as restrictive on investment incentives.

Those who carry on small businesses but on Corporate structures, also find it difficult to bear the burden of the Corporation tax as they have to depend upon more on share capital than on loan capital. The relative incidence of Corporation tax on different sizes

of Corporate businesses is also different and operates against the smaller units.

(b) The regional distribution of tax burden in India is also considerable. Being citizens of the same State of India the people in the different States with comparable incomes have to bear very widely different burdens of taxes. The *per capita* tax in Rupees in Part A States and Part B States in India varied from Rs. 11.8 in West Bengal, and Rs. 13.3 in Bombay. In Uttar Pradesh, Rs. 8.3 in Madras, Rs. 11.2 in Hyderabad, Rs. 11.8 in West Bengal, and Rs. 13.3 in Bombay. In respect of individual taxes also, like Sales-tax, State Excise, Land Revenue, Entertainment tax, Motor Vehicles tax, etc., the burden is widely different in the different States. The difference, however, can be examined if the income levels in the different States are correlated to the patterns of consumption in those States. This position may well be scrutinised by the Commission on the basis of the figures collected by the Finance Commission and the National Sample Survey made by the Government of India.

In the Municipal areas in different States there is also considerable disparity in the burdens of tax. For example, the *per capita* tax realised by the Madras Corporation in 1949-50 was 13.3 as compared to Rs. 19 in Bombay and Rs. 14 in Calcutta.

The Chamber would therefore like to suggest that while some degree of State-wise differences may be unavoidable attempts may be made for bringing more parity in the burden of the taxes in the different parts of India, by touching the people in low-taxed States through levy of such indirect taxes which may reach them.

Question 14.—Shifts in Distribution of Income and Relative Incidence of Tax.

Though the Chamber does not possess any authoritative statistics to measure the extent of the shift in the distribution of income during the recent years, there is no gainsaying the fact that considerable shifts in income have taken place due to the high agricultural prices, transfer of the increased workers' wages to the rural areas, and the policy of the Government in different economic matters, specially labour.

The shift in income has first been towards rural areas and then again from the middle income brackets towards the workers in the factories and generally towards lower income groups. The following figures indicate the rise in the deposits of Co-operative Banks and Post Office Savings Banks as compared to decline in the Scheduled Banks. This shift indicate that there has been a shift of income and saving from middle and upper income bracket depositors of Scheduled Banks to the rural and lower income group customers of the Co-operative and Post Office Savings Banks.

Deposits of Co-operative Banks, Post Office Savings Bank, and Scheduled Banks.

(In lakhs of Rupees.)

	*Co-operative Banks.	Post Office Savings Bank.	Total.	Scheduled Banks.
1946	57,80	1,15,05	1,72,85	10,32,46
1952	1,01,65	1,09,81	3,05,46	8,60,12
Increase or Decrease	+47,85	+84,76	+1,32,61	-1,72,34

*Figures are for 1945-46 and 1951-52.

But there has been hardly much change in the relative incidence of taxation between the rural and the urban areas or between the middle income earners and the workers.

The Chamber may mention that while the level of income of the middle class people have gone up by not more than 200 per cent. during recent years, their cost of living has increased by roughly 400 per cent., thus leaving hardly any margin of savings for this class of people, whereas the average annual earning of a worker in West Bengal increased nearly 5 times since 1939.

Question 15.—Burden of the Cost of Tax Compliance.

It is widely complained that the operational cost of tax compliance resulting from onerous requirements as to maintenance of records, returns, and accounts and the methods and processes of assessment and collection have affected the tax payers morale. Avoidance of tax is reported to have resulted from the rigours and complexities of tax compliance. The procedure and machinery for receiving and reviewing appeals have also been considered to be costly. For all these reasons, in respect of several taxes particularly Income-tax and Sales tax, it is stated that the cost of compliance materially adds to the financial and psychological burdens

of the taxes involving wastage of time and energy. In respect of Income-tax (including Corporation tax) assessments are often considered to be capricious and appeals have to be preferred and with success; but then too, the expenses of such winning appeals are not allowed. Income-tax assessments particularly in respect of trades, professions, etc., are usually very long-drawn, involving considerable costs to the assessee. The Procedure, Rules and Regulations are cumbrous with the result that costly experts have to be employed, and the tax payers participation in the assessment processes are difficult. The procedure adopted for assessment of custom duties sometimes adds to the risk of business as uncertainties and delays are involved in classification of the items for the purpose of assessment, and refund of excise duties have also affected exports. In the administration of Income-tax, Sales-tax, and Customs duties, economic and trade considerations are often neglected and too much legalistic and accounting attitudes are taken.

Question 16.—Benefits for public expenditure *vis-a-vis* tax burden.

The pattern of public expenditure and the benefits that accrues from such expenditures do materially affect the burden of taxation and the taxable capacity. For example, if the security, administrative and debt services take the bulk of Government expenditure and the people are left to make their own provisions, for the welfare services and social security provisions, and if the industries are called upon to bear more and more the responsibilities for such services to the industrial labour, then the citizens and the businessmen should be left with a larger share of their current incomes. It appears from the report of the National Income Committee's findings that the aggregate public expenditure in the total national expenditure constitutes roughly 9 per cent. to 10 per cent. of which some 2 per cent. is spent on Defence, nearly 1 per cent. on administrative capital expenditure and the balance of a little over 6 per cent. on current Governmental expenditure including Civil Administration, costs of collection of revenue, debt services, etc.

No doubt, during the recent years, there has been a tendency to increase the share of welfare services in the total Governmental expenditure but still, it seems that at the present stage of development, and the people's psychology, the level of public expenditure cannot be raised to any large extent. In Australia, the burden of the welfare tax that has been imposed during recent years, or the burden of the increased indirect taxes in the U.K. are not considered to be very heavy because of the free services that are provided by the State in respect of education, medical aid, unemployment, old age provisions, food subsidies, at standards acceptable to the tax payers. In the Indian taxation, when it is found that such measures are not possible to be provided at present, except for the relatively poorer section of the society who do not pay much tax, the level of taxation should be kept at a low percentage of the National Income so that the provisions can be made by the tax paying people themselves in these fields of social securities. The present beneficiaries of the welfare services of the State can be made to contribute something to the Government only through indirect taxes. It should be noted that in an under-developed country, heavy expenditures sustained by taxation, undermines the incentives for work and therefore even if some benefits are included in the public expenditure of India today, then too, the burden of the taxes that would be required to sustain such a policy may affect the productive efforts of the country.

Question 17.—Tax Burden on Particular Industry or Occupation.

It appears that the tax burden is generally heavy on all industries. There is a feeling, however, that the burden on industries like Cotton Textiles, Coal, Jute and on Commercial services like Stock Brokers' Firms, Agency Houses, etc., has been weighing too heavy during recent years. Regarding Cotton Textile Industry, it has been estimated that the total burden of tax at various levels of Government on the Cotton Textiles has been roughly Rs. 50 crores in the shape of Import duty on raw cotton, Excise duty, Cess on Mill-made cloth, Sales-tax and Income-taxes. A pair of Dhuty for which the Mill price is Rs. 12 has to bear an Excise Duty and Sales Tax of Rs. 3 and such additions are proving too heavy. In respect of Coal and Sugar, the aggregate burden of income-taxes, Cesses and Excises, have also been considered to be very high in relation to the present trends in the prices and profit in those industries. In respect of Cotton Textiles there is heavy consumers' resistance and it is hardly possible for the industry to shift the burden of Excise duty to the consumers and the industry also can hardly bear it. In respect of certain other industries which have to depend principally on foreign markets like, Jute and Vegetable Oils Industry, the Export Duties prove to be very high and burdensome for the industries. It has been stated that export duty on Linseed and other Vegetable Oils have sometimes worked out to be 40 per cent. of the value of the

product. The burden on the Jute Industry is indicated by the fact that while there is full working in the Jute Mills in foreign countries, there is restriction on working hours and there is sealing of looms in Indian Jute Mills.

Generally speaking, the burden on the business, professions and trades, carried on by the Hindu Undivided Family have also been considered to be high in view of the present methods of taxation of Hindu Undivided Families.

Question 18.—Taxation *vis-a-vis* Borrowing to finance Development.

The Chamber is of the opinion that for developmental programme of the country in the public sector, greater reliance should be put on borrowings whether from within the country or from outside, than on taxation. At the present stage of development, it may not be possible to raise the necessary funds by expanding the orbit of direct taxation so as to cover a very wide section of the people, at the same time the financial position of the existing establishments does not also enable them to bear even the present burden of taxation while implementing the development programme assigned for them in the Five Year Plan. The Chamber considers that for the development programme of the public sector, attempts should be more for mobilisation of voluntary individual savings by borrowing in different forms and less for imposing involuntary savings on the community through the device of taxation. The Planning Commission observed that the public and private sectors "can well supplement each other and need not necessarily expand at the expense of the other but both must draw from the same fund of social savings". From this consideration also, when taxation is taken recourse to for development programme in the public sector, the availability of funds to the private sector gets seriously affected. For a mixed economy utilisation of current revenue secured by taxation, for the purpose of long-term investment operates against the private sector, specially when the fund of social saving is small relative to requirement.

Question 19.—Priorities in maximising the Financial Resources for Development.

For expenditure on productive development schemes more reliance should be placed on loans and not on current revenues. For non-productive developmental expenditures the economy and rationalisation in the public expenditure (both revenue and capital) should be looked upon as the first step for strengthening the developmental resources. In the next place, attempts may be made to secure larger contributions from non-tax sources, particularly Government's Commercial Undertakings. Better administration of the taxing machinery may also increase the revenues by prevention of tax avoidance and tax evasion in respect of several taxes at State levels. The resources may also be increased to a considerable extent by increase in land revenue, agricultural income-tax and introduction of small excise duties on a wider range of industries, re-adjustment of sales-tax at differential rates; introduction of salt duty and readjustment of the prohibition policy may also increase the resources of the Government. The Chamber does not feel that there is any scope of increasing the rates of existing taxes, at least so far as the major Heads are concerned.

Question 20.—Public Versus Private Sector in the Development Programme *vis-a-vis* Taxation.

The Question appears to be too broad and the views of the Chamber may be found indicated in replies to other question. It would, however, like to emphasise that the tax policy should leave sufficient incentives for enterprise and hard work and adequate portion of the social savings should be left for the private sector. For development of the public sector, borrowings, especially from foreign countries and contribution of labour and services by the individuals should be more adequately relied on. In a tax policy which may be suitable for the private sector of the economy, the following principles should be adhered to:—

- (a) The policy should not unfavourably affect the under-noted five-fold incentives:
 - (i) Incentive for enterprisers for establishing new companies or for development of new industries;
 - (ii) The incentives for those choosing to go into business for themselves rather than going in for service, which alone can maintain the vigour of the private sector in a mixed economy;
 - (iii) Incentive for existing business to expand plant and equipment and to introduce new machinery and methods;
 - (iv) Incentives for the people to invest their money savings in business undertakings;
 - (v) Incentives for the qualified personnel to assume the exacting tasks of executive and managerial positions for efficient operation of the private sector.

- (ii) The tax policy should secure the two basic conditions for the functioning of the economy of the private sector, viz., maintenance of a constant flow of venture capital into the system and provisions for keeping the level of effective demand for the goods and services at par with the progress in production.

It is generally felt that the present taxation system is unsuitable for development programme of the country on the basis of a mixed economy, because, (a) the income-tax rates are proving confiscatory at higher levels, (b) the Agricultural sector which accounts for nearly half of the National Income bears less than 19 per cent. (including land revenue) of the tax load, (c) taxation of Corporate incomes and the degree of progression at middle and higher income brackets of personal incomes affect economic propensity to risk, venture and invest, (d) while profits are heavily taxed there is inadequate scope for adjustment of losses, (e) the cumulative effect of taxation on business firms being heavy, investment is curbed, and uncertainty about the future level of taxation, especially the fear of confiscatory taxation; (f) inadequate tax concession to the middle and upper income brackets from whom mainly venture capital flows, (g) inadequate emphasis on indirect taxes for widening the coverage of taxation, (h) very low level of local taxation especially in rural areas. The Government's schemes for Sickness Insurance, Compulsory Provident Fund, etc., put additional burdens on the industries. Relief therefore is needed to have capacity to bear these burdens.

Question 21.—Tax Policy and Capital Formation.

As has already been mentioned in reply to Question No. 18 above, for the capital expenditures in the Public Sector, greater reliance should be placed on mobilisation of voluntary individual savings than on taxation. It has also been mentioned in reply to Question No. 21 how Tax policy may aid capital formation by providing a larger scope for saving and by limiting the restrictive effect of taxation on the major incentives required for capital formation.

To aid individual voluntary savings, the saving capacity of the traditional savers need be strengthened. In this context, the Chamber would like to stress that the capacity of saving for this group of savers has been seriously affected during the recent years. The burden of tax on the middle income groups ranging from say, an annual income of Rs. 15,000 to Rs. 1 lakh has been very high. It stood at 14 per cent. in 1950-51, for the group earning Rs. 15,000 to Rs. 25,000, at 24 per cent. on Group earning Rs. 25,000 to Rs. 50,000 and at 38 per cent. on those earning Rs. 50,000 to Rs. 1 lakh. The draft on those earning between Rs. 1 lakh to Rs. 2 lakhs was 49 per cent. in 1950-51, and on those earning above Rs. 2 lakhs was 86 per cent. The draft on this last Group was as high as 92 per cent. in 1947-48. Such heavy taxation coupled with high cost of living has seriously affected the capacity to save. The net balance of savings of the Corporate Bodies have also been very small in the face of heavy taxes. Secondly, whatever savings there have been, have flowed to Insurance Companies and the Banks and the major portion of such savings have to be invested in Government securities and kept in deposit with the Reserve Banks, in terms of respective Statutory provisions. The remaining small portions of the savings find their way to a limited sector of established trade and industry and therefore capital formation through newer industries and trades in the Private sector has been extremely difficult.

Firstly, the capacity of the investors needs to be increased by tax relief. Secondly, larger measure of incentives may be offered to the potential investors in the form of exemption of investments in approved Industrial Shares from taxation in the years of investments. A limit can be placed on the quantum of such relief in terms of percentages of income so invested. A larger measure of tax reliefs to new industries and approved old industries, in order to enable them to offer quicker and higher returns to the investors, along with some tax relief on the dividends received from such industrial shares in the hands of the shareholders of such Companies, may also help capital formation. By such measures the incentives for the investors class can be increased by re-adjustment of Income-tax and Corporation tax.

The Chamber would also like to mention that Life Assurance is decidedly a good channel through which the act of saving can be made more attractive. For this purpose, the limit upto which Insurance premia paid by the insured assesses are allowed for income-tax rebate should be increased. Special tax treatment of Life Assurance Companies can also make Life Assurance cheaper and more attractive. The lower income Groups and Workers can be touched through Life Assurance. The savings mobilised through Life Assurance Companies would find their way both in Government Securities and other approved Securities.

Capital formation through differential taxation of distributed and undistributed profits of Companies in

the private Sector would also be a desirable policy, as has been recommended by the Planning Commission.

Question 22.—Decline in Capital Formation.

As has been previously observed capital formation in the private sector has been affected during the last four or five years due to various disincentives against saving and investment. The high cost of living and steep rates of taxation affected the saving capacity of the middle and upper income Groups who had traditionally the maximum propensity to save. The high rate of personal income tax seriously affected the incentives for further work and earning income among the individuals, as any additional income did not leave for them sufficient net income after taxation. The talks of nationalisation in the first flush of Independence, Business Profits Tax, Capital Gains Tax, various types of regulations and threats of further regulations, limitations on dividends and similar other measures affected the incentives for saving. The low rate of depreciation allowance and high costs involved in replacements coupled with the application of Section 23A of the Income-tax Act, depressed the formation of physical capital through Corporate savings.

The Chamber is not in possession of any authoritative evidence as to the rate of private capital formation for the country during the recent years, and during the pre-war period. But one non-official estimate which was quoted by the Fiscal Commission indicated that there were definite dis-savings in the year 1947-48, and there was also a negligible rate of saving at 1.4 per cent. of the National Income during 1948-49, and the Fiscal Commission also felt no hesitation to conclude that the rate of private capital formation in the country had declined. The decline would also be clear from the comparison that according to the computation of Dr. Colin Clarke, while the rate of investment constituted about 7 per cent. of the National Income in India throughout the period 1919 to 1938, the Planning Commission have estimated the rate of savings in the community to be only 5 per cent. of the National Income in 1950-51. Some idea about capital formation in the private sector through Joint Stock Companies can also be had from the changes in the paid-up capital of Joint Stock Companies in India. The total paid-up capital of Joint Stock Companies was Rs. 123 crores in 1919-20, it increased to Rs. 261 crores in 1929-30, to Rs. 304 crores in 1939-40 and it stood at Rs. 628 crores in 1948-49. The growth of capital during the second decade was thus of the order of Rs. 138 crores, and it declined to Rs. 43 crores during the third decade, while during the forties the increase was to the tune of Rs. 324 crores. Taking into consideration the fall in the value of the Rupee, to roughly one-third, the real growth of paid-up capital during the fourth decade can be estimated to be of the order of Rs. 108 crores as compared to Rs. 138 crores during the second decade. The third decade was primarily a decade of world wide depression. The injection of new capital into Joint Stock Companies during recent years has been very inadequate compared to the needs.

The Chamber feels that there has been considerable shift during recent years in the capacity and incentives to save both among the individuals and the Corporate Bodies. As has been pointed out, due to factors indicated above, and also mentioned in reply to Question No. 21, the capacity and incentive for the traditional savers in making their contributions to the capital formation declined during recent years. The capacity of the Corporate Bodies also declined. The middle and upper income Groups have been the traditional savers and the records of deposits in the Post Office Savings Banks and Co-operative Banks when compared with those of the Scheduled Banks, would indicate that there has been shift in the volume of saving towards the rural areas and also toward the lower income Groups. Such shifts in incomes have also been reflected in larger demands for consumption goods. The nature of demands of different classes of people, both in terms of quality and quantity, which the business men daily experience, definitely point to a shift in income.

Question 23.—Tax Relief in Middle Income Group and Savings.

The Chamber feels that tax relief in the income groups liable to be taxed at the maximum rate of personal income tax may substantially assist the growth of saving in the community. Larger allowances for insurance premia and allowance for investments in approved industrial shares and in approved bonds, may considerably contribute to capital formation from the current incomes of the middle income group. It has been shewn in a recent study that nearly four-fifths of the shares in Indian Public Companies are held by middle income groups.

Question 24.—Planning Commission's Estimate of Capital Formation.

The Chamber is not clear whether it would be possible to divert fifty per cent. of the additional out-

put to investment each year after 1956-57 as envisaged by the Planning Commission. It, however, feels that if the adjustments indicated in reply to previous Questions are adopted immediately, then the capital formation in the private sector may be considerably increased.

Question 25.—Regulation of Consumption for Releasing Larger Resources for Development.

The Chamber does not feel confident that much regulation of consumption standards is desirable, because it is found that most of the consumption group industries are already facing the problem of extreme buyers' resistance. The absorption capacity in the country is proving inadequate for the programmed development. Secondly, the Chamber is not also clear whether tax measures would be appropriate for such regulation of consumption. The Planning Commission also make significant observation in this regard when they say that "direct taxation of the rich is likely to impinge more on their savings than on their consumption". It is felt that direct taxes on the rich would be non-effective for the purpose of regulating consumption. Appropriate measures for a higher level of indirect taxes may achieve the purpose to some extent. While it is felt that much tightening of the belt may not be possible for the majority of the people, some result may be achieved if systems of deferred payments of bonuses to wage earners, and provisions similar to it are adopted for certain middle income groups on whom the burden of direct tax may be lightened.

Question 26.—Tax Policy vis-a-vis Efficiency of the Productive System.

The major incentives on which the vigour of a productive system, particularly in the private sector, depend, have been indicated by the Chamber in reply to Question No. 20. In brief, these include the incentives for entrepreneurs to undertake ventures, scope and incentives for expansion, incentives for investors, and incentives for managerial personnel. The maintenance of a constant flow of venture capital into the system is one of the essential pre-requisites for maintaining the vigour of a productive system based on mixed economy. The tax policy can influence these incentives and can thereby promote the efficiency of the productive system. The efficiency of a productive system also depends to a large extent on the scope for modernisation of plants and machines, and for undertaking the rationalisation of industries. So, by adjustment of the tax policy the industries can be provided with larger scope for ploughing back of their profits for needed replacements and modernisations and thereby to improve the efficiency.

For optimum utilisation of money, material and machines, in the productive system, loads of taxation on each of these factors can largely affect the efficiency of the productive system. The tax on the money that flows to the productive system should be lower than on that which flows to current consumption, and thereby the productive system may be helped. In respect of import duties, and other State taxes, the raw materials should be taxed at a lower level, and all manner of double taxation at Central and State levels of such raw materials of industries should be lowered. For example, if the same raw cotton is subjected to import duty, and then again to sales tax, then the cost on raw materials gets higher and brings in rigidity in the cost-price structure. The import duty on capital goods and machinery needs also to be kept very low for promoting efficiency by modernisation of plants and machinery at relatively cheaper costs. Tax allowances for rationalisation may also help the productive efficiency of the industries.

As has already been pointed out high rates of personal income-tax at middle income brackets affects the incentives for work among the Business Executives and Professional Experts, who also largely determine the efficiency of the productive system.

The multiplicity of the taxes in India has subjected the flow of trade and income to a number of taxes, the cumulative effect of which cannot be easily measured, though can be felt by those having experience of trade. For example, a pair of Dhuty which may be priced by the Mill at Rs. 12 per pair in Bombay, would have to bear a little more than Rs. 3 by way of Central Excise Duty, Bombay Sales Tax and West Bengal Sales Tax.

The lack of uniformity from State to State of various taxes, particularly Sales-tax, have affected the free flow of trade among the different parts of the country and has in that way affected the productive efficiency of the economy. The widely varying tax load in the different States, as has been pointed out before, has significant effect on the channelling of investments to different parts of the country. Private capital must have a tendency to flow towards those areas where the aggregate tax load, as also the complexities of the taxes, are less.

As to rationalisation of the country's tax structure to arrest this diversionary effect of taxation, the Cham-

ber's opinion would be indicated from the replies in the subsequent Questions. At this place it may be mentioned that although complete uniformity may not be possible in a vast country like India organised on a Federal idea, much greater uniformity can be secured by the constitution of something like a Board of Inter-State Commerce and Revenue which Body may, *inter alia*, be entrusted with the work of keeping close watch on the undesirable effect of divergent taxes on the allocation of resources. The State Governments should come to some understanding about mutual consultation through such a Board, in the interest of the economy as a whole. Some other tax adjustments needed to invigorate the productive system in the private sector are indicated under Question No. 20.

Questions 27 and 28.—Taxation to Secure Order of Priorities in Development Programme.

The Chamber is generally sceptical about the use of taxation as a gear for economic control. It feels that there are obvious limitations of a tax policy to do the job, though every tax must have some economic effect. The Chamber would therefore mention that the desired order of priorities in the Development Programme should be attempted to be secured by more direct means than taxation. Special tax treatment of new industrial undertakings generally, and of those industries for which programmes of development have been drawn up would however be justified on the principle of social expediency. Some additional incentives may be provided by tax concession to investors in such industrial undertakings. Such tax adjustments would be only adjuncts to aid the priorities decided otherwise.

Question 29.—Scope and Efficacy of Tax Policy vis-a-vis Monetary Policy and Direct Controls.

Tax policy is only one aspect of the general Fiscal Policy comprised of Budgetary policy, Expenditure and Investment Policy, Borrowing Policy and Debt management policy. The whole Fiscal Policy again requires to be co-ordinated with the Monetary policy involving credit policy, stock market policy, banking policy, and the like. The monetary policy, and direct controls in the field of investment, regulation of industries, regulation of foreign exchange, regulation of foreign trade, etc., are likely to be more efficacious than a tax policy. A tax can be effective only in coordination with other facets of fiscal, monetary, banking and general economic policy.

Questions 30 and 31.—Taxation and Reduction of Inequalities.

The urge for reduction of inequality is appreciated by the enlightened Business Community. The Planning Commission observes that "there is need for balancing the advantages of greater equality of income and wealth against the disadvantages of a possible fall in private savings and capital formation". The Chamber would like to emphasise that relative to the present stage of development the taxation during the last few years and other measures in respect of wages, labour welfare, etc., have brought about significant reductions in respect of inequality of income. So far as taxation is concerned it has over-reached its limits in reducing inequality. It has affected the taxable capacity of the community. The inequality that existed for ages in the country has no prospect of becoming wider in the present context of things. But the Chamber must emphasise that any attempt to increase the pace of reduction in the inequality may reduce the taxable capacity to an undesirable limit. Capital resources are essential for production of income and re-distribution of an inadequate quantum of National Income means only a shift of income to those sections of the community who possess the highest propensity to consume. The Chamber thinks that reduction in the inequality is bound to gradually come about in the process of development programmed for the country.

The Chamber would also like to mention that the newer principles for regulation of wages, salaries, etc., have made the use of taxation for increasing the equality or reducing the inequality unnecessary. There are many direct ways for it and greater degree of economic equality can come only with greater increase in the National Income for which incentives to capital formation must be maintained, at the present stage among the traditional savers' class.

Question 32.—Public Expenditure for achieving Equality of Income.

No doubt, heavy public expenditure may apparently achieve some amount of equality of income. If larger measures of welfare services are adopted out of such public expenditures, then the bulk of the benefits accruing to the lower income groups may bring about a greater measure of economic equality. But when such heavy public expenditures are sustained by high level of taxation, then in a mixed economy such taxation tends towards inflation because the incentives for hard work, investment and production are likely to get affected. Thus the supply of goods and services are likely to fall short of the money supply with the result

that inflation sets in with its resultant effect on the entire economy. Continuous inflation again may bring about a different pattern of inequality. In an underdeveloped economy like that of India heavy public expenditure in non-productive lines can hardly have any effect on reduction of inequality.

Question 33.—Tax Policy and Foreign Investment in India.

The Chamber does not propose to make any suggestion in this regard.

Question 34.—New Taxes.

(a) and (b): *Estate and Succession Duty.*

Regarding Chamber's views on Succession and Estate Duties, please refer to the Answers to Question Nos. 101 and 102. The Parliament has already proceeded with the legislation. The Chamber still maintains that it has been inopportune in the very first stage of development.

(c) and (d): *Terminal Tax and Taxes on Railway Freights.*

Regarding taxes on Railway fares and freights, and Terminal Taxes, the Chamber is of opinion that in the present rates structure of the Indian Railways there is already a tax element in so far as monopoly freights charged do not seem to be justified. This would also be clear from the fact that every year there is heavy surplus in the Indian Railways and a portion of it also goes to the general revenues of the Government. Secondly already the Railway Freights have exceeded the level which the traffic can bear. There is therefore no justification for additional taxes on Railway fares and freights. Moreover, the Indian Railway freights having already exceeded the limit of what the traffic can bear any addition is likely to affect the yield of freight itself.

(e) With the Act for regulation of Futures Market and with possible legislation for regulation of Stock Exchanges, the functioning of these essential adjuncts of the Private Enterprise System likely to be impeded. These should not therefore be further burdened with a tax load. The flow of credit would also be affected.

(f) The Newspapers being the principal vehicle for public opinion, and the prices of newspapers being already very high, taxation of the sale or purchase of newspapers may not be desirable and feasible at the present moment. A tax on advertisements would add to the business costs and the Chamber is not in favour of advertisement tax.

Question 35.—Views re : Some Possible Tax Measures.

At the present stage of capital formation, the Chamber does not consider it advisable to tax capital. On the contrary, in taxation measures it should be ensured that the capital which is the source of income is not impaired.

Regarding *Salt Duty*, the Chamber is strongly of the opinion that the duty may be reintroduced, and even a moderate rate of duty may bring roughly Rs. 10 to Rs. 12 crores to the coffers of the Government without much addition to the tax burden of any individual, as the coverage would be maximum. The Chamber is fully conscious of the political aspect of this duty but it feels that in the changed circumstances of the country and when the Governments are undertaking many welfare services, the reintroduction of the duty should be considered as justifiable. If the Government feel that the public psychology may still be affected then, the receipts from the duty may be kept earmarked for rural development or for some specifically approved social service.

About *surcharges on land revenue*, the Chamber considers that if agricultural income-tax is appropriately introduced the need for surcharge on land revenue may not be there. Moreover, such additional surcharges on land revenue would make the tax more complex.

Regarding *betterment levies*, the Planning Commission seem to consider that it may be possible in new development areas. But the Chamber feels that such betterment levies may not prove feasible at the initial stages and therefore the scope of such levies during next few years may not be very much.

About *agricultural income-tax*, the Chamber is definitely of the opinion that there is considerable scope for increasing the revenues of the States from this sources. At the present, level of Agricultural income-tax is negligible in India. The Taxation Enquiry Committee of 1924 also recommended for introduction of a progressive rate of Agricultural income-tax in case of large holders. The receipts from land revenue and Agricultural income-tax now constitute less than 10 per cent. of the total public revenues at all levels and the share of Agricultural income-tax in the revenues of the States works out to roughly 1 per cent. only.

About *social security taxes*, the Chamber would like to point out that in a way, a section of Indian indus-

tries has already been put under this tax in so far as compulsory Provident Fund and Sickness Insurance Schemes have been introduced enjoining upon the employers to make contributions. The Chamber is not clear whether the coverage of social security taxes can be so extended as to yield much revenue with which any acceptable measure of social security can be provided for the people in general. The basic difficulty in any social security scheme in India at the present stage is that the coverage of the beneficiaries must be too wide and the number of those who may be called upon to bear the tax would be too few. In post-war Great Britain also while some £1,500m. was spent on social services out of the total expenditure of £3,898m. in 1950-51, on specific tax as social security tax was introduced. Community services and measures of social security on considerably wide scale were provided by the Labour Government on the basis of some extension in indirect taxes.

The Chamber considers that in undue haste to realise the *policy of prohibition*, the income from State excise duties have been unduly lowered with incommensurate result on the prohibition policy. The revenue from State excise declined from Rs. 6.2 crores in Bombay in 1948-49 to Rs. 1.1 crore only in 1952-53 and in Madras the revenues from State excise was brought down to Rs. 34 lakhs only in 1952-53. The Committee do not feel that such declines really reflect the progress in the prohibition policy. The Chamber feels that while the revenues can be brought down by a Governmental decision, the habits of the people cannot be easily changed. It therefore, feels that the prohibition policy as laid down in the directive principles of the Constitution, can be better given effect to by imposing restrictive rates of duties on the liquors while at the same time those who continue to remain addicted to this vice may be made to contribute to the State coffers which money can be spent for the community's social services.

Question 36.—Levy of a tax on Unearned Increments in value of Land and other Property as a result of Public Projects of development.

The Planning Commission observe that "betterment levies, designed to draw into the Public Exchequer a proportion of the capital gains that accrue to private parties as a result of development are a recognised device for strengthening public savings". The Chamber feels that such taxation of capital gains so to say, should not be resorted to at the present moment. While such increments in value of the properties in rural areas may be considered as largely unearned, it can in no wise be looked upon as undeserved or undesirable. While such unearned accretion in value may be there, the risks and the period of waiting involved in owning such land and other properties in undeveloped areas should also be taken into consideration. Moreover, the Chamber feels that such accretions would help capital formation in the private sector. A levy on unearned increments is also likely to be administratively difficult and complex.

Question 37.—Measures for Increasing Receipts from Existing Sources.

In the opinion of the Chamber better administration of the taxing machinery may increase yield of several of the existing taxes. If better relations between the tax administrations and the tax payers can be established and the procedure of taxation can be simplified, and the load on individual assessee can be lowered in respect of certain taxes, then avoidance and evasions may be also minimised, with consequential result on the aggregate yields. By way of illustration, the Chamber may mention that in respect of several taxes like Sales-tax in West Bengal, the full tax payers' coverage does not seem to have been as yet secured with the result that the tax operates as iniquitous against those who pay the tax as also the general consumers, while the yield continues to remain relatively low.

Question 38.—What other New Sources of Taxation can you Recommend?

Please refer to the Answer to Question Nos. 34 and 35 above, regarding the Chamber's views on new sources of taxation.

Question 39.—Central Surcharge on Taxes.

Except under emergent conditions, the Chamber is not in favour of imposition of Central surcharges on the taxes or duties whether of the Central Government or of the State Governments. Regarding the surcharge on Income-tax the Chamber strongly urge for abolition of the present surcharge.

Question 40.—Limitations of the Tax Policy to cope with Inflationary and Deflationary Situations.

Basically, the Chamber is not clear about the efficacy of taxation as an instrument for meeting inflationary and deflationary situations. As has already been pointed out, tax policy is after all only one aspect of

the fiscal policy which, in its turn, cannot work without monetary policy. While thus, the tax policy cannot accomplish the tasks of combating inflation or deflation, it can to some extent be helpful in making the other antidotes effective. For such use of the taxation also, the economy and for the matter of that, the markets of the country must be sufficiently organised and the statistical measures and gauges must be well developed so that the Government may use such measures at the correct time and in the correct manner.

Under the present Indian conditions, the Chamber is particularly doubtful about the efficacy of the tax policy as an instrument for dealing with inflationary or deflationary situations. By way of illustration, the Chamber may point out that the ostensibly anti-inflationary taxation in India during recent years has been considered by many to have more affected the flow of venture capital and the country's exports, than really checking inflation. It would be found that the anti-inflationary taxation did not succeed till the monetary and credit policies could be made effective from the beginning of 1952. The Chamber would like to point out that it is always difficult to decide the limit at which taxation may just curb the inflationary excesses and may not impair business incentives. The Committee would also point out that frequent changes in taxation and tax rates, which the utilisation of the tax policy for combating short-term economic fluctuations would involve, affect business planning, and thus whatever good may be secured by such utilisation of the tax policy is more than offset by business instability that it brings forth. The time-lag between proposals and implementation of the adaptations proposed, and between tax receipts and expenditure, create uncertainty and hesitation in taking business decisions. Frequent changes in Customs Duties also generates speculative tendency in the country's foreign trade.

Question 41.—Efficacy of Different Individual Tax Measures to Combat Inflation or Deflation.

The general views of the Chamber about the efficacy of the tax fabric in combating inflationary or deflationary situations are indicated in Answers to Question No. 40 above.

At the present moment the rates of Corporate and individual income-tax are so high that even if there is a little inflation, it would be ruinous to go with the idea that such inflation can be countered by increasing such taxes still more. In this context the Chamber would like to stress that the War-time and Post-war high levels of income-tax and super-tax, and imposition of Excess Profits Tax, Business Profits Tax, and Capital Gains Tax seriously undermined the capital formation in the private sector, but had little effect in countering inflation of the War and Post-war years. The Chamber would also mention that in the course of implementation of the Five-Year Plan, a huge amount of money would be released into the economic system putting inflationary pressures on commodity prices, and deficit financing would also add to this inflationary tendency. But if taxation is to be utilised as an aid to keep such inflation under control, then the measures must be able to mop up the small funds of additional income that would be released during the Planning period among a larger number of people throughout the country. Unless mopping up of such additional incomes is possible, taxation measures as an anti-inflationary technique is bound to be non-effective. In an eagerness to apply the technique, if efforts are made only to hunt up the collective savings available in the organised businesses and if the microscopic proportion of the population who pay income-tax is only to be fleeced, then the policy would affect capital formation and incentives for work, saving and investment, while proving non-effective as a counter-inflationary measure. In the opinion of the Chamber Direct taxes are unsuitable for countering inflation, in the context of India's conditions. As the bulk of the productive instruments are operated by those who pay direct taxes, measures to lighten the tax burden on industry and trade may however, invigorate the economy.

Among indirect taxes, the adjustments in the import duties in times of goods scarcity may arrest the inflationary spiral by increasing the supply of goods in relation to the available purchasing power. The yield of the duty may also increase, thus bringing in revenue while mopping up a portion of the purchasing power in the community.

The experiences of the Chamber about the use of Export Duties in countering inflation during recent years have not been encouraging. The Chamber is doubtful about the equity and efficacy of this device to combat inflation. During 1938-39, Export duties covered only two articles, viz., jute and Rice and yielded Rs. 4 crores out of a total revenue of Rs. 42½ crores while in 1951-52, Export duties covered 10 commodities and brought nearly Rs. 50.5 crores out of a total gross revenue of Rs. 145 crores. It has been claimed that by the device of levying Export duties, the taxation policy has contri-

buted to combat inflation in India. The Chamber, however, feels that the export trade of the country has been to a large extent damaged by such a policy because of the inevitable time-lag involved in making appropriate adaptations. The Chamber feels that there is inherent limitations in using Export Duty for such purposes. In its opinion the Government should relieve the country's export trade from the strangle-hold of Export Duties.

The Excise and Sales taxes virtually impinge on consumption. A judicious use of these taxes with timely adaptations may influence inflationary or deflationary trends to some extent. For example, the reduction or abolition of Excise Duty on mill-made cloth may contribute to bring down prices of cotton textiles at present. The levy of Salt Duty and imposition and/or a slight increase in Excise Duties on those goods which are consumed or used by almost the entire population may contribute to mop up a portion of the additional money that has flowed and would flow to the workers, peasants and other income-tax exempted categories of people, and thus some check may be put on the inflationary pressure of the developmental expenditure. But downward re-adjustments are necessary in respect of some products like cotton textiles where the prices are facing consumers resistance.

About Sales Tax, the Chamber is of the opinion that the revenue urge of the State Governments have already made the tax extremely complex and restrictive of trade, and therefore there should be no attempt to add yet another complex function to it.

Question 42.—To what extent is it possible to increase the inherent capacity of the tax system to counteract inflation or deflation?

The Chamber's views regarding the scope and inherent limitations of tax policy as an instrument to deal with inflation and deflation are indicated in replies to Question Nos. 40 and 41 above. Moreover, as the Chamber has observed at the very outset (Reply to Question No. 1), it is not in favour of such non-fiscal use of the tax policy. In other countries with much developed and organised economies, and where the coverage of direct taxes is fairly high, there may be some scope for utilising taxation as a contributor to to counter inflation or deflation. But in those countries also tax policy is looked upon in such circumstances only as an adjunct of other policies, monetary and non-monetary. In the context of things in India there should be still less reliance on tax policy for such purposes. The question of increasing the inherent capacity of the tax system, by itself to deal with inflation or deflation, seems to be therefore premature. In times of money inflation the Government should go in for mobilising small savings, may float loans, etc., for pumping out the additional purchasing power. In times of deflation on the other hand more money may be pumped in by various devices, like re-payment of loans, drawing upon the cash balances of the Government, cheaper credit policy, etc.

Question 43.—Public Expenditure *vis-à-vis* Inflation or Deflation.

Public Expenditure programme can substantially influence the inflationary or deflationary situations. But the pattern of expenditure would be significant. For example, the high level of public expenditure, undertaken by the Government under the Five-Year Plan, being principally of long-term capital nature and partly of non-productive welfare category, cannot but have an inflationary pressure on the economy, and deficit financing would add to this pressure. If this high level of expenditure is to be financed out of current revenues secured principally by direct or indirect taxation of those who constitute the backbone of the private sector of the economy, then that may mean crippling of the economy, inspite of a high level of public expenditure, as the private industry and trade responsible for the supply of the goods and services would be crippled. Stagnancy of the economy with growing unemployment, along with an inflationary trend may thus result from such a pattern and level of public expenditure backed up by such a scheme of financing. For curbing inflationary pressure, adjustments in public expenditure pattern and slowing down its tempo, and efforts to mobilise small savings may be more efficacious and effective than any other instrument.

In times of deflation or depression, the policy of undertaking programmes of public expenditure on projects like Road construction, Irrigation, Housing and other similar types of Public works, was effectively adopted in many countries during the depression days of the thirties. Increase in public expenditure has been resorted to for invigorating the economy during those days. But it may be worth considering, under the Indian conditions, whether increase in public expenditure or tax reduction would be desirable for meeting a deflationary situation or a depression. In the Indian Economy private sector provides the people with the bulk of the employment opportunities, and tax reductions are likely to more effectively invigorate the

economy by means of larger and wider investments, than an increase in public expenditure by an equal amount. Such tax reductions would directly influence investment incentives, while an increase in public expenditure in non-productive lines is likely to increase consumption incentives. It has however to be noted that some increase in public expenditure in selective lines of public works of high utility may be also necessary and desirable. In times of deflation therefore a combined policy of increased public expenditure and tax reduction may be most effective.

Question 44.—Using tax policy to deal with the effect of rising or falling prices on particular groups of tax payers or sectors of the economy.

As already explained in the replies to several previous questions, the Chamber is not generally in favour of relying on the tax policy to deal with the effect of price fluctuations. It is therefore of the opinion that the tax adjustments are not suitable instruments to counter the effect of short-term price changes on the different sections of the people. Monetary and credit measures and public expenditure policies are better instruments. But tax adjustments along with other measures may be necessary if the rise or fall in prices persist over a considerable period of time and exhibits trends for stabilisation at higher or lower levels.

Question 45.—Present Phase of Economy and Needed Adjustments.

So far as the industrial products are concerned, there is deflationary trend in the market. Generally speaking, the absorption capacity within the country is falling short of the expansions achieved in the field of industrial production. In the international prices of the major counters of India's export trade, there is also a strong deflationary trend. There are rigidities, however, in the cost-price structure, particularly of the industrial products, including the rigidity provided by the load of taxation. The high level of public expenditure, which is predominantly of a capital or non-productive nature, is providing an element of inflationary pressure in several sectors, particularly in respect of food articles, and this is likely to continue. A layer of prosperity among the peasants and workers may sustain that pressure. In respect of business profit, which is very strategic in determining the volume of new investments and economic expansion on the basis of a mixed economy, the declining trend has gone to the limit of almost becoming dis-incentive. The rate of new investment or expansion in the private sector, is proving to be too low to provide gainful employment to the growing population. The tax adjustments, therefore, are to be made on the canvas of these trends.

For providing wider opportunities for employment, the tempo of new investments over wider fields of business activities may be increased by a revision of the public expenditure programme, and by providing wider scope and stronger incentives to those sections of the community who traditionally possess the propensities to save and invest. By such expansion of investments the volume of employment and production can be increased with a better adjustment between the rates of expansion and absorption of the goods produced.

The adjustments in the fields of taxation which the Chamber has in view have been indicated in the course of replies given to the previous Questions and would be given in more concrete terms in its replies to other parts of the Questionnaire.

PART II—DIRECT TAXES

Question 46.—Determination of 'residence'.

In the opinion of the Chamber, the alternative test of residence, viz., (i) location of control or management, or (ii) relation between extra-territorial and inter-territorial incomes as provided in Section 4A(C), should be guarded with some proviso so as to secure that a foreign company before getting the privilege of set-off of any foreign loss, in any year it becomes resident (because of more than 50 per cent. income in India), should bring at least an equal amount of foreign profits in India in subsequent years, when it becomes non-resident because of more than 50 per cent. income abroad. The recommendations of the Income-tax Investigation Commission in para. 48 of their Report appears to be pertinent if the present alternative test of residence of Companies is to be continued. Broadly speaking, the Chamber would suggest for introduction of such tests of residence as may secure to India the tax on the entire income that arise in India and there should be no charge on foreign profits.

The Chamber is of the opinion that the special category described as "not ordinarily resident" in Section 4B should be abolished as was recommended by the Income-tax Investigation Commission. Some special provision for the foreign technical personnel who may be employed in India, at the present phase of the country's economic development, may however, be made.

Question 47.—Definition of Income.

In the opinion of the Committee, there is no way out than to leave the "definition" as of a very general nature as in Section 2(6C). No exhaustive definition seems to be feasible and the definitions attempted to be given in certain foreign laws, as in the Income-tax Laws of Canadian Provinces, are of a very broad nature though very long.

The Chamber would, however, like to explain that the concepts of revenue incomes and expenses in income-tax accounting should not be very different from those in business accounting. With this end in view, some principles should be enunciated in the Act itself. In this connection the Chamber may invite the attention of the Commission to the principles enunciated in respect of income in the case of the Commissioner of Income-tax *versus* Messrs. Shaw Wallace & Co. where the following observation is made:—

"Income in this Act connects a periodical monetary return coming in with some sort of regularity or expected regularity, from different sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere wind-fall."

The exclusions made in Section 4(3) (vii) may be further clarified so that no receipt which is considered to be of a capital nature in business accounting may be attempted to be included within income for the purpose of taxation.

Question 48.—Heads for Income-tax: Taxation of Capital Gains.

The heads of income chargeable to income-tax as mentioned in Section 6 of the Income-tax Act seems to be comprehensive. Incidentally, the Chamber would suggest that "Dividend" should be shown as a head along with "Interest on Securities" in Section 6 of the Act against head No (ii) instead of being put under head number (v), "Income From Other Sources".

The Committee would also like to mention that in the Finance Act of 1953, it has been prescribed that speculative losses can be set off only against speculative gains. The underlying principle seems to confirm the view of the Chamber that an income in order to be charged under standard income-tax should be regular and recurring. In the opinion of the Chamber, if speculative losses are not allowed to be set off against regular and recurring incomes, speculative gains or incomes should not also be included within the normal income for charging income-tax. Such irregular and non-recurring gains or incomes may be treated separately for taxation.

The Chamber is definitely opposed to the taxation of capital gains at the present stage of economic development of India. Taxation of capital gains is bound to seriously affect risk taking incentives and ventures and would thus impede capital formation. It is administratively complex and the yield may not warrant for taking recourse to such a measure in peacetime economy. With the introduction of the Estate Duty all capital gains would be taxed on the death of the last holder of the property and therefore a separate capital gains tax would be still more undesirable.

Question 49.—Taxation of Profit accruing or arising abroad on their repatriation to India.

The question mentions only the issue of taxation of foreign incomes on repatriation. The Chamber would like to emphasise that foreign incomes of the residents should be completely exempt from Indian income-tax.

The Chamber would also stress that when such foreign incomes are repatriated, it should be exempt fully from income-tax without conditions being imposed on the manner of investment of such repatriated foreign earnings and savings.

Such a procedure would encourage the Indian nationals to take up business in foreign countries and repatriate their incomes for investment in India. Such repatriated foreign earnings and savings should be allowed to flow in the private sector without hindrance. The income that would arise out of such investments would naturally be taxed in subsequent years and therefore such repatriations should be encouraged.

Question 50.—Definition of Dividend.

It appears that no change is needed in the definition of 'dividend' in relation to bonus shares. The bonus shares release no asset of the Company, nor do such shares add to the liquid spending power in the hands of the recipients. Secondly, the issue of bonus shares affects the value of the existing shares and therefore, if the bonus shares are to be taxed as dividends, the depletion in the value of the existing shares would also have to be allowed. But such adjustment would

be virtually impractical. The issue of bonus shares is a time-honoured method for capitalisation of the past savings and therefore it should not be impeded by taxation, particularly at a time when capital formation and need for speedy development are considered urgent and vital in the country.

Question 51.—Taxability of non-residents through their business connections in India: Sections 42 and 43 of Income-tax Act.

The Chamber feels that the present provisions of Section 42 and 43 put the importers in India in an uncertain position, because of the interpretations put to these provisions in administering these. The sections should be suitably modified so as to secure the following:—

(a) An Importer, or even an Agent or an employee in India of a non-resident foreign trader or manufacturer, should not necessarily be liable to be assessed on behalf of the foreign Suppliers or the Principal. The general qualifications of an Agent in order to be assessed in a representative capacity, should be stated in the Act itself.

An Agent in order to be selected as a representative assessee should have the general authority to negotiate and conclude contracts on behalf of the non-resident Principal, or should be in possession of a stock of merchandise for the purpose of fulfilling orders. There should not be any question of such representative taxation in Principal to Principal contract, or when an independent Commission Agent or a Broker or a Custodian acting in the ordinary course of business does business with a foreign trader.

(b) While the Chamber agrees that the entire profit arising out of trading in India, should be taxed, it should be categorically ensured that in eagerness to tax such profits, no profit which may arise out of trade with India (but not in India), may be subjected to Income-tax in India. For example, when goods are sent by a foreign Principal to his Agent in India, the entire profit should not be treated as profit arising in India at the time of sale here. The manufacturer's profit should be separated from the trader's profit and only the latter should be taxed in India. The Chamber understands that specific provisions exist in the Australian law in this regard and those may be examined by the Commission.

Unless these provisions are effectively secured, both in the law and in the administration, the position of the Indian Importers remains uncertain and the foreign exporters may insulate themselves by insisting on sending goods at F. O. B. prices; and the agency and consignment business become difficult.

In this connection, the Chamber would like to observe that it is opposed to recommendation No. 6 made in paragraph 44 by the Income-tax Investigation Commission as to the method of assessment of the non-resident foreign trader by selecting one resident representative as responsible for the entire tax liability of such a non-resident. If a foreign trader has more than one qualified Agent in India, it should not lie on the Income-tax Officer to select any one of such representatives for the entire tax liability of the foreign Principal.

Question 52.—Definition of Agricultural Income to avoid Double Taxation.

The definition of agricultural income as given in Section 2(1) would require modification so as to avoid the scope of double taxation in respect of incomes and dividends of Agricultural, Plantation and Forest Companies. In the opinion of the Chamber, the Act should categorically declare that if the income from the Plantation Companies and Companies engaged in forestry be agricultural income then the dividends paid out of such income should also be considered as of the same nature as the total income of the Company. It should be conceded that if an income is agricultural in the hand of the Company, then the dividend declared out of such income should also be considered agricultural in the hand of the recipient of the dividend.

The Chamber would, however, prefer integration of agricultural and non-agricultural incomes for income-tax purpose and in that case, the issue regarding dividends declared by Agricultural Companies and Forest Companies would get resolved.

Question 53.—Integration of Agricultural Income with non-Agricultural income for rate purpose.

As income from all other sources are integrated for the purpose of Income-tax, there seems to be no particular economic justification against integration of money income arising from agricultural sources, with those arising from other sources for the purpose of income-tax. In other countries also, such integration is made.

If, however, such complete integration is not considered feasible as a matter of expedience, the Chamber

would *alternatively* suggest that at least on consideration of "ability to pay", net agricultural income, after deduction of all expenses incurred for earning that income and the agricultural tax paid on such income, should be integrated with non-agricultural income for determining the rate of income-tax under the Central Act.

The Chamber does not visualise much difficulty in such integration on constitutional grounds, but because Agricultural income-tax has not been introduced in the majority of the Indian States integration of the two incomes for rating of the non-agricultural income need be preceded by the introduction of Agricultural income-tax in all the States.

Question 54.—Abolition of distinction between Agricultural income and non-Agricultural income and change of the Constitution.

If the first alternative suggested in reply to Q. No. 53 above, be accepted then that would automatically involve complete centralisation.

Even if the two incomes are kept separate, and Agricultural income is taken into consideration only for the purpose of rating, as suggested in reply to Q. 54 above, then also the Chamber would strongly favour the centralisation of the administration of agricultural income-tax for and on behalf of the States. With this end in view, the Constitution should be changed, or even in terms of the present Constitution, the State Governments should empower the Centre to levy a uniform agricultural income-tax for the allocation among the States on the basis of the collections.

Question 55.—Treatment of irregular and fluctuating incomes.

In the opinion of the Chamber, the present treatment of irregular and fluctuating incomes require modification so as to specifically provide for averaging of all irregular and fluctuating incomes arising from business, profession or vocation, over a number of years.

The incomes arising out of recognised speculative transactions should particularly be treated as fluctuating incomes for the purpose of such averaging. Risk investments yield uncertain and irregular incomes and averaging of such incomes for tax purposes would promote investment incentives.

Secondly, in case of lumpsum receipts, at intervals, these should not be taxed in one year as the income of that year in which these are received. Similarly, profits of contractors can be calculated only in the year of completion of the contract and so such profits should not be considered as income of that particular year but should be spread over the period involved.

Such spreading technique is being worked out under the Federal Income-tax law of the U. S. A. in respect of incomes of authors, inventors, lawyers, etc., who work for long for no or little income and then receive large incomes and then again may have to wait for long. Prorate adjustments are allowed over the earning period. This principle has also been introduced in the Indian Income-tax law by the Finance Act of 1953 which makes provisions for giving relief to Authors, Painters, etc. The Chamber would suggest the extension of the principle of averaging and spreading in respect of dividends and all other fluctuating incomes which are received at intervals.

In this connection it may be mentioned that such averaging technique existed in certain States of the U.S.A. (like Wisconsin) till 1934 where the fluctuating incomes were taxed on the basis of "three year moving average"; the tax payer paid a tax each year on his average income of the taxable year and the two previous years. In the Depression of the thirties, it was given up, being burdensome on the assessee. But the difficulty is not insurmountable.

The scheme may be that the tax-payer would pay every year on the income of the taxable year, but at the end of a stated number of years, he would be entitled to claim refund if the taxes paid in the meantime, exceed the tax on the periodic average income by say, 10 or 15 per cent.

Question 56.—Exemption of Religious and Charitable Trusts.

All genuine Trusts with religious or charitable purpose should be given recognition in accordance with certain procedure laid down in the Act itself, and the incomes under any head of such recognised Trusts should be exempted and the relevant Section should be amended suitably. It should be ensured in the law itself that religious or charitable Trusts may not experience difficulty in obtaining recognition.

Recently, Section 4(3)(i) has been amended so as to restrict the exemption of income from business of a religious or charitable institution only in those cases where the business is carried on 'in the course of carrying out a primary purpose of the institution'. This

amendment seems to have unduly restricted the exemption envisaged in the Act previous to the present amendment. India is striving for a Welfare State, therefore if a Trust carries on business and spends the income for public welfare within the country, then such charitable trusts should be encouraged, and the income from business of such charitable trusts should be completely exempted from income-tax without the conditions imposed by the recent amendments. The emphasis should be on the purpose of expenditure and not the source of income.

It, may, however, be ensured that any foreign Trusts not carrying on any charitable work or work of public welfare in or for the benefit of India should not be exempted.

Question 57.—Taxation of Co-operative Enterprises.

The business profits of Co-operative enterprises should be brought within the purview of Income-tax (including super-tax if levied separately on other enterprises), at par with other types of enterprises. The Chamber would, however, agree to a special exemption in respect of those Societies which keep their transactions restricted within the membership of such Societies.

If a Co-operative enterprise carries on business activities with outsiders, the Chamber does not find any reason to exclude the profits of such an undertaking from income-tax, to which the joint enterprise of the shareholders of a Company and the Company itself are subjected.

Except in the case of a Tenant Co-partnership Housing Society, the Chamber is not in favour of exemption of any other type of Co-operative Housing Societies from income-tax.

Question 58.—Tax Concessions to New Industrial Undertakings.

In the opinion of the Chamber, the present tax concessions to new industrial undertakings provide inadequate incentives for investment in new enterprises. A 6 per cent. dividend allowance is by itself very small compared with the risk involved in the new enterprises and the scarcity of investment capital in the country. Secondly, this concession continues at present only for five assessment years following the year in which an assessee begins to manufacture the goods. It is to be conceded that this period is inadequate, because during such initial years, it may not be possible for the Company to declare even the exempted rate of dividend. Thirdly, in many new industrial undertakings, after the initial and extra depreciation allowances are adjusted, there remains hardly any profit for the purpose of declaring a 6 per cent. dividend. In the opinion of the Chamber therefore, the incentives sought to be provided by this exemption is not of much real benefit in promoting new industrial undertakings.

For new industrial undertakings, the Chamber would suggest the following measures:—

- (a) a 9 per cent. dividend should be exempted from income-tax and corporation tax for five years from the year in which the new undertaking starts earning profits and this dividend should be cumulative.
- (b) 25 per cent. of the investments in a new industrial undertaking should be allowed in the assessment of the investors.

The Chamber would like to emphasise that the investors may be given adequate incentives for investing in the new industrial undertakings and the period of exemption in respect of dividend should be made effective beyond the initial no-profit period.

For the suggested concessions, the period within which the new undertaking must be started should be extended upto 1960.

Question 59.—Concessional treatment of profits of foreign branches of Indian Banks.

Even if foreign incomes of resident Indian businessmen continue to be subjected to income-tax in India, on the present basis, then also profits of foreign branches of Indian banks should be given special concessions in respect of their foreign profits. The Chamber is of the opinion that in view of the special need for encouraging the opening of branches by Indian banks in the foreign countries, such concessions would be justified.

In this connection the Chamber would also emphasise that to encourage the foreign business of Indian Insurance Companies, the profits from foreign branches of such Companies should also be treated with concessions under the Indian Income-tax.

Such concessions to or even exemptions of foreign incomes of Indian Banks and Insurance Companies would materially help the foreign trade of the country and would add in invisible exports.

Question 60.—Limits of Exemption from Tax of Life Assurance premia and contribution to Provident Fund.

In the opinion of the Chamber, to aid individual voluntary savings, as also as a measure of social security, all encouragement should be provided for individuals to take out life insurance policies. The present limit of exemption for life insurance premia and Provident Fund contributions, etc., which is to the extent of one-sixth of the total income or Rs. 6,000 (for a Hindu Undivided Family Rs. 12,000) whichever is lower, requires alteration. The habit of life assurance has not developed to a large extent as yet.

While the proportion of 1/6th may continue, the upper limit of Rs. 6,000 should be raised to at least Rs. 10,000 for an individual and the same amount for each Co-partner for a Hindu Undivided Family.

The increase in the upper limit would not enable an individual to go in for over-saving as apprehended by the Income-tax Investigation Commission, because of the limitation in terms of the proportion. Such a measure may very greatly contribute to the rehabilitation of the economic conditions of the middleclass and may ensure for them a useful existence in future. Greater incentives for life assurance would also help capital formation because the premia income of life assurance companies would flow to investments, roughly half being in Government securities. Incidentally, it may be observed that to encourage life assurance, the life assurance business should also be accorded special treatment in taxation, as envisaged in Q. 32.

Question 61.—Depreciation Allowances and Replacement Assurances.

(i) The Chamber feels that there can be hardly any controversy about the need for granting larger depreciation allowances and other assurances to the industry in order to finance the considerably increased costs involved in the replacement of the assets.

The present method of computing depreciation on the basis of historical costs can, however, provide only the full value of their original cost of the assets. The problem for the older industries of India is to secure enough funds for replacing their old assets at a cost nearly 3—3½ times of the corresponding original costs. The crux of the issue seems to lie in this net differential cost involved in replacement of the older assets. The whole idea behind depreciation allowance is to safeguard impairment of capital. But the calculation of such allowance on historical basis secures only 100 per cent. of the original capital and not more than that. Special provisions are therefore needed for securing this net differential cost to the older industries. Subject to these observations, the views on the different proposals raised in the Questionnaire are as under:—

(a) The present scales of depreciation allowance on new assets should be continued in order to partially aid the increased cost of replacement of older assets but this procedure may be of temporary benefit to the industry as it is virtually the acceleration of the allowance rather than any extra allowance in the long run.

(b) The method of revaluation of existing assets is considered by many Experts as a more effective and reasonable method. But the method appears to be too complex and therefore in consideration of the needed simplicity, it may not be suitable for India immediately.

(c) The principle of treatment of the excess of replacement cost over the original cost as revenue expenditure, has been adopted by the Government in replacement in Indian Railways. In financing the Five Year Plan, also, the principle of using revenue income for capital expenditure has been adopted by the Government. The same principle may be partially applied in the case of industrial undertakings by liberally permitting a portion of the capital expenditure to be charged against the current profits. The Chamber however is not clear about the effectiveness of such a principle in a business undertaking, particularly in the present phase of declining profit or no profit. An industrial undertaking may not have profit enough against which a portion of the capital expenditure can be charged as a revenue item.

(d) In the opinion of the Chamber, an extra allowance, computed as a percentage of the block assets, should be granted to industry, to create a Rehabilitation Reserve Fund. An example may make the suggestion more clear. If Rs. 1 lakh was the original cost of a machinery and if the present replacement cost is Rs. 3 lakhs, then the net increased cost of replacement is Rs. 2 lakhs. The previous depreciation allowance and enhanced allowances introduced during the recent years, can only shorten the period of accumulating the original cost of the machinery and not this net differential cost. A special Rehabilitation allowance should be granted to create a Rehabilitation Reserve Fund of the order of this Rs. 2 lakhs within a period of say 10 or 12 years from now. If such an allowance is granted, before computation of the Income-tax (and Corpora-

tion tax), this would practically mean that the Government would be contributing only the tax leviable on the amount of such allowance and the undertaking itself would be contributing out of the current profit, the balance of the amount so funded.

In this connection the Chamber may also mention that in several other countries also special arrangements have been made for such replacement of assets, and obsolescence allowances have been specifically granted in the U.S.A. and U.K. Under the proposals made here, the industry would be contributing the larger share in the replacement and the Government would have only to forego the tax on the amount funded which may be looked upon as obsolescence allowance. For example, if Rs. 1,000 is so funded in an undertaking, in any year, then assuming the tax to be 40 per cent, the Government's contribution will be roughly Rs. 400 and the industry's contribution out of its current profits would be roughly Rs. 600, which would otherwise go in the net profit for appropriation under other heads.

(ii) In the opinion of the Chamber, assistances to the industries to replace their older and obsolete assets would benefit not only the undertaking itself but the economy as a whole, as the entire cost-price structure would then be readjusted at lower levels due to increased efficiency of production. In view of the need for larger measure of industrialisation and to put the Indian industries on a level of efficiency the special assistance that may be given to the Indian industries should be looked upon as national expenditure, the social benefit of which will be not less than the benefit of any other nation-building work.

Secondly, it should be conceded that the older industries require this special assistance for replacement of the assets because of the high prices of the plants and machines and the urgent need for replacement of these assets which were over-worked during the war years. The high prices of the products which were produced by such over-worked machinery brought in higher profits but such higher profits secured by over-working of the machines were largely appropriated by the Government by way of Excess Profits Tax and other imposts. The public resources thus were unduly strengthened out of such higher profits which were in a way, earned by the industry by almost killing the goose which lay the golden eggs. Extension of special assistance now to replace these older assets would thus be justified on all counts.

(iii) The Chamber appreciates the concern of the Commission that the special tax concessions that may be given to the industries to meet the problem of replacement finance, should be utilised for the purpose for which these are intended. This can be fully secured if it is provided that the Rehabilitation Reserve Fund as proposed in (i)(d) above, be made taxable, if it is not utilised for replacement of the assets for which it was created, within a reasonable period or stated number of years. The Chamber feels that the industries in their own interest would utilise such concessional funds.

Incidentally, the Chamber would like to mention that there is a feeling that under all the above methods that may be examined for assisting industry to finance the increased cost of replacement of assets, the shareholders would be called upon to bear the main burden of this additional replacement cost. It is apprehended that under all these schemes, the Companies shall have less capacity to offer any return to the shareholders. This may further affect the investment incentives of the private investors. Such a line of argument suggest that the Government should examine the possibility of subsidising the older industries from which large amounts have been collected by way of income-tax and super-tax during the years 1943-52. The Government heavily taxed the industries during these years when profits were earned by over-working the machines. The Government should now help these industries to replace the assets by subsidising the additional expenditure involved. Such subsidies may be related to the amount of tax paid by each undertaking during the period mentioned above (i.e., refund of tax), and may be available only if the industry replaces their plant within a stated period, say 15 years, for the purpose of modernisation of the machinery.

Question 62.—Classification of Assets for the purpose of Depreciation, Rates of Depreciation, etc.

About the question of classification of the assets, the Chamber considers that the present classification is satisfactory, excepting some modifications that may be made for making the classification more clear as in the case, say, of different types of buildings.

Regarding rates and methods of computing the allowance, complications sometimes arise, and the relevant Schedule may be scrutinised in order to avoid possible divergence of opinion in respect of interpretations and to secure that the assessments are not unduly complicated regarding the issue of computing depreciation allowances.

Question 63.—Tax concessions to encourage development of Mineral Resources.

It needs hardly to be stressed that all encouragement should be given for development of the mineral resources of India. In mining industries the expenditure on prospecting is considerable and is a very risky investment. This expenditure should therefore be considered to be the first charge on any income that may be earned on the success of the exploration. The adjustment should be spread over the estimated life of the mining concession successfully explored. Without such concessions for adjustment, it would not be feasible for Indian enterprises to undertake the prospecting of mineral resources.

In addition to such allowance for adjustment of prospecting expenditure, the mining companies should be completely exempted from income-tax during the first five years of successful working.

In the next place, depletion allowances should be granted on the wasting assets of mining companies. The mining leases suffer capital losses at the expiry of the terms of the lease and therefore depletion allowances should be granted to the mining companies for building up necessary funds for replacement of assets at the expiry of the lease and such depletion allowances should also take into consideration the amounts that may be paid by the mining companies by way of *selami* for taking out leases of either the mine proper or any other surface land for the construction of *cutchra* or *pucca* buildings. Such depletion allowance should thus be on the basis of the total cost of prospecting and original acquisition of the lease and 100 per cent. exhaustion of estimated reserve, or on the basis of full recovery of the total cost during the lease period in case of periodic leases.

In mining companies, special treatment of assets like plant and machinery may be also required because the life of such plant and machinery would be largely dependent on the life of the mine or the mining lease, and not on the normal life of the plant or the machinery itself.

In this connection it may be mentioned that in the U.S.A. under the Federal Income-tax law, as also in the U.K., depletion allowances are granted. The Chamber may also invite the attention of the Commission to the Report of the Commonwealth Committee on Taxation of Mining Industry in Australia submitted in 1951, which made exhaustive recommendations for special tax concession in mining industry. Those schemes of granting special allowances and for Sinking Fund allowance in respect of mining leases, may be examined for India also.

Question 64.—Personal and Family Allowances.

Almost all foreign countries provide for certain personal allowances and allowances for married persons and dependents, old age relief etc. In India on the other hand, wife's and children's incomes are added up to increase the load. The Chamber would strongly recommend for granting of allowances for family members and dependents on a *per capita* basis, though some limit may be put to the number of such family members and dependents for whom allowances would be granted.

Besides these family and dependent's allowances, specific provisions should be made in the Act for allowance of certain casual losses like thefts, destruction of property by fire or natural calamities.

In the opinion of the Chamber, even if such allowances are granted, for family members and dependents, there would remain justifiable allowance like say, medical expenses, etc., for which specific provisions may not be possible. For this, the first slice of exempted income may be increased to say Rs. 2,000. But the Chamber would urge for granting of specific personal allowances for family members and dependents, and in its opinion such legitimate allowances cannot be provide adequately and equitably by exempting the first slice of income. In other countries also, such allowances are given on specific basis.

In this connection the Chamber would mention that in most of the Canadian Provinces medical expenses in excess of 5 per cent. of income is allowed and dependents are defined to include son or daughter under 21 years of age or if 21 years of age, or over, but is likely to remain dependent on account of mental or physical infirmity, and a stated number of individuals who may have to be supported by the tax payer and are connected with him by blood relationship or marriage, or by formal adoption.

As to the total amount that should be allowed for each family member or dependent, a fixed amount may be laid down for each dependent and family member.

In the case of a Hindu Undivided Family, allowances should be granted on *per capita* basis on the same principle as for individuals but in respect of each Coparcener in the family.

Question 65.—Admissible expenses in Business Income.

In the opinion of the Chamber, the admissible expenses catalogued in Section 10(2) of the I. T. Act should be revised in order that the gross revenue may be charged for whole of the expenses incurred in earning the revenue and with all other expenses or losses incurred for the purpose of the business or arising out of or in connection with the conduct of the business. The Chamber understands that the Tucker Committee of the United Kingdom more or less agreed with the Institute of Chartered Accountants of England about this approach in admitting expenses for a more equitable computation of business incomes.

As far as the Committee are aware, a lot of difference of opinion arise in respect of the admissibility of an expense for income-tax purposes and it has often been complained that the profits are too much inflated by the income-tax officers for the purpose of taxation by the device of disallowing the expenses which have actually been incurred and paid out by the assessee. The result is that taxes levied over a number of years sometimes exceed the actual income received by the assessee during those years. The disallowance thus made by the I. T. Officers on various grounds are reported to have led to capital taxation, and exhaustion of the financial position of the assessee.

The Chamber therefore would urge for a clear-cut statement of principle in the Act itself that no expenditure should be disallowed, if such expenditure is charged to revenue income according to accepted accounting principles.

Several expenses have to be made now-a-days by businessmen as a matter of business prudence and expediency and such expenses should in no wise be disallowed as being merely personal expenses, 'not wholly and exclusively' spent for the purpose of business. The Income-tax Investigation Commission observed that the cost of personal requirements was sometimes deliberately shown as business expenditure. The Chamber would like to emphasise that many such expenses now-a-days have to be incurred by the businessmen which are really not personal expenditure but have to be incurred wholly on business considerations and to further the interests of business. The status and position of a man in business, profession or vocation should be accorded due consideration in allowing business or professional expenses.

The Chamber would specifically mention only a few items which should be allowed as admissible expenses and it would request the Commission to prepare a more comprehensive list of allowable expenses in order to avoid the possibility of assessing tax on inflated notional incomes rather than real incomes.

(i) Under the Sea Customs Act when certain items are imported and the law declares such imports to be unauthorised, the goods are confiscated but the importer is given an option to buy the goods at an enhanced price in lieu of confiscation. Such prices, which the Importers are called upon to pay in obtaining goods are considered to be 'penalty' prices and are therefore not admitted as an expense. It must be conceded that without such payments the goods from which the income arises could not have been secured. If goods are not taken by the original Importer and these are auctioned by the Customs and are purchased by a third party then the whole price is allowed to such a buyer. It should be considered that as illegitimate receipts also come within the purview of income for tax purposes, such prices even if these are penalty prices, should be considered as cost. Such 'penalty' prices can in no wise be mixed up with other types of penalties.

(ii) Secondly, the expenditure incurred in respect of taxation appeals is not allowed even though the appeals are won. Such expenditure on successful Income-tax Appeals should be allowed on consideration of justice and equity.

(iii) The legal and preliminary expenses for formation of a Company should allow on the same method as these are charged to profit in accounting. Similarly, capital losses should also be allowed to be adjusted.

(iv) Water Rates, Road Cess, etc., should be allowed.

Question 66.—Rates Structure.

(a) & (b): Consolidation of Income-tax & Super-tax.

In the opinion of the Chamber, income-tax and super-tax should be combined into a consolidated levy. Such consolidation would simplify the rates structure and would be more understandable by the ordinary taxpayer. The super-tax, after all, is only an additional levy on income and therefore there seems to be hardly any justification for taxing the income in two or three different names. The consolidation of the two rates of income-tax may also make it easier for an assessee, specially the smaller ones, to comply with the tax requirements with a lesser pressure on time, energy and expense. For the Administration also, it would be simpler in completing the assessments. The complexi-

ties of separate treatment of allowances, etc., in respect of income-tax and super-tax may also be made simpler by such consolidation.

The more crucial point for the assessee in India today is however, the issue of lowering the total burden of the tax on income, so that the levy may be more socially expedient at the present stage of the country's development requiring maximum incentive for saving and investment.

(c) Degree of Progression in Income-tax and Super-tax.

The degree of progression appears to be unsatisfactory for ensuring speedy development of the economy. The application of the maximum rate of 48 pies per rupee plus 5 per cent. surcharge on earned incomes above Rs. 15,000 and levy of maximum rate of Super-tax of as 8 pies 6 in the rupee on all incomes above Rs. 1½ lakhs have made the burden of the tax inequitable for the upper and middle groups of income earners and disincentive for capital formation.

In the next place, the progression introduced at the different slabs of income, also appears to be unsatisfactory. This will be clear from the following rates of basic income-tax:—

Rates of Income-tax per Rupee.

	1939-40	1947-48	1953-54	
	Rs. 1—1,500	Nil	Nil	Nil
Next	Rs. 3,500	9 pies	12 pies	9 pies } + 1/20th surcharge
Next	Rs. 5,000	15 p.	24 p.	15 p. } + 1/20th surcharge
Next	Rs. 5,000	24 p.	42 p.	36 p. } + 1/20th surcharge
Balance of Income	.	30 p.	60 p.	48 p. } + 1/20th surcharge

It would be found that while in 1939-40, the increase from the third slab to the fourth one was 9 pies in the rupee, in 1953-54, it is more than 21p. per rupee. The increase from the 4th slab to the "balance slab" in 1939-40 was 6p. as compared roughly to 13p. in the rupee in 1953-54. The rate is graduated only upto an income of Rs. 15,000; on the excess of income over Rs.15,000 the rate is really proportional.

In super-tax also, the rates in 1939-40 were as under:—

Rates of Super-Tax in 1939-40.

First Rs. 25,000	—	Nil.
Next Rs. 10,000	—	1a. in the Rupee
Next Rs. 20,000	—	2a. in the Rupee
Next Rs. 70,000	—	3a. in the Rupee
Next Rs. 75,000	—	4a. in the Rupee
Next Rs. 1 lakh 50 thousand	—	5a. in the Rupee
Next Rs. 1 lakh 50 thousand	—	6a. in the Rupee
Balance	.	7a. in the Rupee

In 1939-54, the rates are:

On the First Rs. 25,000	—	Nil	
On the next Rs. 15,000	—	3a. in the Rupee	+ 1/20th surcharge
„ Rs. 15,000	—	4a	„
„ Rs. 15,000	—	6a	„
„ Rs. 15,000	—	7a	„
„ Rs. 15,000	—	7½a	„
„ Rs. 50,000	—	8a	„
On the balance of total income.	—	8½a	„

It would be found that not only the rates are much increased at each slab, the progression too stands accelerated.

Incidentally, it may be also noted that the exemption limit for super-tax has remained same at

Rs. 25,000 and the first slice of exempted income also stands at Rs. 1,500 as these were in 1939-40.

The Company rates of income-tax and super-tax are also very high requiring adjustment in order to encourage investment in Corporate types of business enterprise. The Company rate was 0-2-6 in the rupee in 1939-40 and in the Finance Act of 1953, the rate is as. 4 in the rupee plus 5 per cent surcharge. Though this tax is refundable in the hands of the shareholders, the provision proves ineffective in practice for a substantially large number of share-holders, especially to small investors. The deduction in the hand of the Company also affects the investments incentive in so far as the ordinary shareholders look to the net dividend after deduction of tax as the return they are getting. The mobilisation of small savings thus gets impeded. An Investor in Company shares is thus virtually to bear the income-tax burden of 48 pies per rupee on every rupee of the dividend that he may receive, in addition to the burden of the non-refundable super-tax on Companies (Corporation tax), though such an investor may not be liable to pay any super-tax on his other incomes.

The rate of super-tax on Companies was only anna 1 in the rupee in 1939 and in the Finance Act of 1953, the tax comes out to be 11 per cent. on Companies with incomes below Rs. 25,000 and 17-2 per cent. on Companies having incomes above Rs. 25,000 and fulfilling certain conditions laid down in the Act. For certain other public Companies, whose shares were not offered for sale in a recognised Stock Exchange during the accounting year and which do not fulfil the prescribed conditions and some private limited Companies, have to bear a high rate of -/4/9 in the rupee which works out to 29-2 per cent as non-refundable super-tax on such Companies.

The views of the Chamber regarding super-tax on Companies would be found under Q. Nos. 79-81 below:—

(d) *Alternative Rates Structure.*

In adjusting the rates structure, the Chamber would urge for securing the following points:

(i) Income-tax and super-tax should be consolidated both for the individuals and for the Companies.

(ii) The consolidated rates should be graduated over a longer range so as to reach a maximum rate of as. 9 in the rupee at the level of an income above Rs. 3 lakhs for individuals.

(iii) The consolidated Company rate of income-tax may be 0/4/6 in the rupee and there should be no super-tax in addition to this.

(iv) The first slice of exempted income is to be Rs. 2,000 and the spread at each slab upto the slab of Rs. 50,000 should be Rs. 5,000, the second slab being for Rs. 3,000. After the level of Rs. 50,000, the spread at each slab may be Rs. 25,000 upto an income of Rs. 3 lakhs.

(v) In the consolidated rate of income-tax on individuals, the rate should not be higher at any slab than at present.

(vi) The Chamber would also mention that if the consolidated rates are expressed in terms of percentages, then the rates structure may be more easily understandable to the average tax-payer, making the tax compliance simpler and less expensive.

In case the suggested consolidation of rates are not considered acceptable, the Chamber would urge for the following alternative rates and exemptions:—

(a) The Company rate of income-tax which should be refundable in the hands of the share-holders, should be as. 3 in the rupee and a Corporation tax of 0/1/6 in the rupee, may be levied.

(b) A Company income of Rs. 50,000 should be exempt from Corporation-tax, and the exemption limit for super-tax on individuals should be increased to Rs. 50,000.

(e) *Surcharge under Article 271 of the Constitution.*

The Chamber is opposed to levy of surcharge except in emergencies like war. Even if surcharge is levied there can be no question of graduation again in the surcharge itself, because the income-tax and super-tax on which it is levied are on a graduated basis.

In a peacetime economy, the Chamber would strongly urge for the abolition of surcharge on income-tax. Whatever is realised by levy on income should be on the basis of one consolidated rate.

Question 67.—Exemption Limit for Income-tax.

The present income-tax exemption limit of Rs. 4,200 for individuals and Rs. 8,400 for Hindu Undivided Family seems to be low in view of the present cost of living. The exemption limit was Rs. 2,000 for individual in 1939-40 when the middle-class cost of living was not more than one-fourth of the present cost of living. The

Chamber is not clear whether full adjustment would be feasible in consideration of the revenue needs. It would therefore suggest that the limit may be increased to Rs. 6,000 with adequate adjustments for Hindu Undivided Family on the basis of this amount for each co-parcener in the family.

The exact limit of such exemptions would, however, largely depend upon the extent of individual and family allowances that may be granted in respect of the family members and dependents as suggested before.

Question 68.—Earned Income and Old Age Relief.

(a) Earned income relief is a feature of many modern tax systems. Its economic justification seems to be that the exemption provides against impairment of personal wealth which produce the income. The earned income relief may be looked upon as allowance for "human depreciation", as was observed by Sir Jeremy Raisman while first bringing this new feature into the Indian income-tax in 1945. Earned income relief provides incentive for work and conforms to modern social concepts of work and income. The Chamber is therefore in favour of maintaining the earned income relief.

(b) The definition of "earned income" as given in Section 2(6)(AA) excludes interest from securities, dividends and rents. In the opinion of the Chamber, dividend, interest and rents should not necessarily be considered as wholly unearned. It is true that when securities, shares or rent-earning properties are inherited, the inheritance may not involve personal exertion but when incomes are earned subsequently on these heads by an individual there is certainly exertion involved on the part of the Income earner and the degree of exertion may be sometime more than even exertions to carry on a trade or a profession or employment. So, a certain percentage of incomes under these heads should also be considered as incomes earned by personal exertion and therefore should be entitled to earned income relief. Moreover with the introduction of Estate Duty the unearned element involved in the inheritance of such tools of income would get taxed.

(c) The limit of earned income relief is partly linked up with the provisions for other personal allowances and, also with the exemption limit for taxation. The present earned income allowance is 20 per cent. of the earned income upto a maximum of Rs. 4,000. This upper limit was fixed up in 1946 when the cost of living was much lower and the exemption limit was also much lower. In the United Kingdom the proportion of relief is for 2/9th of the income, but the upper limit is £450, which is more than 3 times the exempted income. It appears that this ratio between exemption limit and earned income allowance may be introduced also in India. This would provide further incentive for work and personal exertion.

The Chamber would also like to mention that in the U.K., Income-tax Act of 1952, "old age relief" to persons above 65 years of age, is allowed at the same scale as earned income relief but the two reliefs are to be in substitution and not concurrent. Under Indian conditions the widows should also get similar reliefs. Such a relief would be a contribution towards old age security if introduced in India (Vide Section 211 of the U.K. Income-tax Act 1952).

It may also be mentioned that under the English Act, the earned income relief is not allowed to non-residents, but in India no distinction is made between residents and non-residents in respect of earned income relief.

Question 69.—Stock Valuation for assessment purpose.

The Chamber would like to emphasise at the outset that so far as the Government's revenue is concerned, too much need not be made of the issue of stock valuation. The valuation of stock should be fundamentally considered as a matter for the assessee to decide according to his business foresight and prudence. It should be also conceded that no standard method would be suitable for all types of businesses. The Company law has also never attempted to make any rigid provision in this regard. Assuming for argument's sake that an assessee increases or decreases the profit of the business of any particular year by over-valuation or under-valuation of the stocks, the profits gets adjusted in subsequent years and thus the Company's tax also gets averaged. The Chamber would therefore prefer a categorical statement in the Act itself that the valuation shown in the final accounts of the assessee should be generally accepted.

In the opinion of the Chamber, the stocks-in-trade should continue to be valued according to accepted principles which is "cost price or market price whichever is lower" and an assessee should be free to adopt the lower of the two prices every year.

The main difficulty that is experienced is about computation of the cost price of the stocks, and two methods are followed namely, "last in first out" and "first in first out". These two methods have been used

in different cases and differences of opinion arise as to the applicability of either of these methods in a particular case. The Chamber would suggest that in order to avoid difficulties and disputes as to the computation of cost price the *average purchase price* may be taken as the cost price of the closing stocks, unless the circumstances of a particular case warrant otherwise.

As to the valuation of the market price, of the closing stocks the Chamber does not agree with the recommendations of the Income-tax Investigation Commission that the Auditors should not accept the certificates of the management of a business undertaking but should compulsorily certify to the correctness of the value of stocks themselves. In the opinion of the Chamber it would neither be expedient nor practicable for the Auditors to undertake the valuation of the stocks themselves, and to certify the correctness of such stocks values. Apart from the question of competence of the Auditors to undertake the work, most companies close accounts almost at the same time and it would be hardly possible for Auditors to check stocks in all cases at the time of the closing. In the market valuation of the stocks the Auditors have perforce to depend on the market information to be supplied by the management.

The problem of valuation of stock in trade, is very vital in calculation of profits in business and the Income-tax Investigation Commission examined the issues involved, to some extent. They discussed certain methods of notional valuation in certain cases on the basis of book values and sales and estimated margins of profit. The Chamber is opposed to any such notional valuation. It may also be mentioned here that the Company Law Enquiry Committee also have not made any rigid recommendation for the valuation of stocks for the purpose of exhibition in the balance sheet.

The Chamber is also opposed to the Income Tax Investigation Commission's suggestion that the Income Tax Officers should be empowered to check stock lists at the time of preparation and to enter premises to satisfy themselves about their accuracy. In the opinion of the Chamber, this will be impractical task for them and such a power with the ITO's would be of little practical value. The verification of the stocks of a sizable business concern would extend for several days and weeks and it cannot be possible for an ITO to undergo the process of physical verification.

Question 70.—Assessment of Hindu Undivided Family.

In the opinion of the Chamber, the assessment of Hindu Joint Family should be such whereby the total burden of the tax on family may not be more than the sum total of the burden which may devolve on the individual earning members of the family if assessed separately. The tax should be neutral in this respect. For this, it appears that the maximum non-taxable limit should be proportionate to the number of adult male members comprising the family. The exemptions and allowances for whole family should be at least equal to the aggregate of the exemptions and allowances available to the Co-parceners if they are assessed separately.

Adequate adjustments should therefore be made for Hindu Undivided Families in respect of earned income relief, allowances paid to one or more members of the family who may manage the affairs of the family, and the insurance premia.

Question 71.—Exemption for Voluntary surrender of Managing Agency Commission.

It is felt that when the Managing Agents have to surrender or refund the whole or a part of their Commission, the amounts so waived or refunded should be exempted. Under the Managing Agency Agreement, the Agents take commission on net profits and they may draw it either on a monthly basis or on an annual basis. Now, in some years the Agents may have to surrender or refund the whole or part of their commissions in order to save the Company and/or to meet the demands of share holders. It has been noticed by the Chamber that if such refunds are surrendered or made in terms of an express agreement to this effect, then exemptions are allowed but, if there is no such express terms in the Agreement, these are not allowed in assessing the Managing Agents, the waiver or refund being considered as *ex gratia* payments. In the opinion of the Chamber, this seems to be unfair. The Managing Agents have sometimes to forego or refund the commission but an express term to this effect incorporated in advance may put the Agents under undue pressure from the shareholders and may give rise to various complications.

The Chamber does not exactly follow the apprehension expressed in the question about misuse of such a provision for exemption of waived or refunded commission. Firstly, the waiver or refund must appear in the accounts of the managed Company also, in addition to the records of the Managing Agent. Secondly, if such waived or refunded commission is exempted from the income of the managing agent it gets included in the managed Company's income, and therefore such amounts

of commission would not go out of the purview of income-tax.

Question 72.—Agreement for Double Taxation Reliefs.

The investments of Indian capital in foreign countries is likely to continue to be small as compared to investment of foreign capital in India. Therefore, the question of giving unilateral reliefs to avoid double taxation is of greater significance to India than of securing such reliefs by agreements because by such agreements, the total quantum of relief that may have to be given to the non-residents in India would be larger than the total relief that may be available to the Indian residents earning in foreign countries.

In making any agreement, it should be ensured that the Government may get the full benefit of the tax in respect of all incomes that arise in India. Secondly, it should be taken into consideration that the reliefs given to non-residents earning in India may be just reciprocal to the reliefs that the residents in India may obtain in the respective countries of the non-residents.

Question 73.—Valuation of Property and Allowances.

In determining the *bona fide* annual value of the property, only half of the tax levied by any local Authority subject to a maximum of one-eighth of the annual value, is at present deducted from the total rental. The Municipal rates have gone very high in many States and in the opinion of the Chamber, such rates should be deducted in full in determining the *bona fide* annual value of the property. The Committee understand that this deduction of Municipal rates from rental was agreed to by the Supreme Court of India in 1950 in their Judgement in the case of Messrs. New Piecegoods Bazar Company Ltd., Bombay, *versus* the Commissioner of Income-Tax, Bombay. But the decision was nullified first by an Ordinance and then by an amendment of the Act in 1950.

Secondly, the Chamber considers that where there are agreements in respect of rent, for a minimum period of say, 7 or 8 years, the annual value should be fixed on the basis of rents provided in such agreements, and in such cases the question of reasonableness which has naturally to be decided by the Income-tax Officers regarding the rent, need not be brought in.

Incidentally, the Chamber would also mention that there should be quinquennial valuation and adjustments in respect of allowances and deductions in order to secure some degree of averaging of incomes and allowances as provided in the Income-tax Act of the United Kingdom.

In respect of deductions, the Chamber would suggest that the allowance for repairs which is one-sixth of the annual value is proving too low under the present circumstances of high costs of material and labour. This upper limit is considered inequitable because of the fact that the cost of repairs have gone up by more than 200 per cent. while the rents have not increased by more than 30 or 40 per cent. except in exceptional cases. This allowance should be increased substantially.

The allowance for collection cost is at present 6 per cent. at the maximum and no house-owner finds it possible to meet the collection costs within this 6 per cent. limit. The Chamber would suggest that this allowance should be increased statutorily to 15 per cent.

Lastly, at present no depreciation allowance is granted on house properties if these are not used for business purposes. The Committee would suggest that depreciation allowance should be granted on all buildings if the income arising out of it is to be taxed in conformity to the principle of guarding against impairment of capital. This would be of particular importance under the prevailing conditions when there is dearth of living accommodation, especially in the urban areas and when the building activities are to be encouraged.

The annual value of the house property constructed between 1st April 1950 and 31st March 1954 is at present exempt from income-tax for 2 years from the date of completion of the construction. In the opinion of the Chamber, this concession may be continued for some years more in order to encourage building activities.

Question 74.—Set-off of Loss.

Adequate provision for set-off of business loss can offer substantial inducement to risk investments. Such set-off provisor in the law injects an element of averaging income and thus brings an amount of equity in taxation. The present provisions in the Indian law are, however, not considered adequate or equitable.

Firstly, the facility for set-off is limited to a period of 6 years only. In the opinion of the Chamber, when a business actually incurs loss, such loss should in all fairness, be first allowed to be set-off in subsequent years before taxing income of such subsequent years. The existing limitation of 6 years means that if a Company incurs loss for 5 or 6 years and then earns profit, it is taxed even before complete set-off of its previous losses. This may even lead to taxation of capital and this limitation period thus works against

those undertakings which may become profitable only after 5 or 6 years. The Chamber would therefore suggest that this limitation period should be abolished.

The Chamber welcomes the recent amendment in Section 24 of the Act which has removed the difficulties that were created by the Supreme Court judgement in the case of *Anglo-French Textiles Company Limited versus the Commissioner of Income-tax, Madras*. The recent amendments have also made it obligatory on the Income-tax Officers to determine the loss for the purpose of carry-forward. But the amendment made by the Finance Act of 1953 prescribing that speculative losses can be set-off against only speculative profits, appears to be onerous to the business community, and in spite of the clarifications made, it seems that complications still continue and may particularly affect the stock exchange and hedging transactions. This provision should therefore be modified suitably.

In the third place, set-off is allowed only in respect of income of the same business. An assessee's financial position is to be guarded, so set-off should be allowed against all other incomes of the assessee, no distinction being made between business income and non-business income.

Lastly, the Chamber would like to stress that set-off of loss should be granted even before making adjustments for making depreciation, if there is any limitation period for such set-off. It should be conceded that depreciation is a device for creating a fund for replacement of the assets at the expiry of its life, whereas loss made is a loss of liquid cash. The loss incurred thus, is an impairment of the liquid position of the assessee which requires to be replenished against subsequent profits before any question of making provision for future replacement of assets can be considered. The limitation period sometimes does not enable the assessee to get the benefit of set-off.

Carry-back of Loss

The question refers to carry-back of loss only in case of cessation of business. The Chamber would like to emphasise that this carry-back allowance should be granted in other cases also particularly to the newer industries which were started during the post-war and post-Independence boom period. Such carry-back allowance was in vogue for long in the United States, and even in the Revenue Act of 1950, there was one year carry-back allowance for net operating loss. If even in the developed condition of the American economy, carry-back of loss could be permitted then it stands to reason that some provision for carry-back of loss for a period of 3 or 4 years may greatly help the Indian industries, particularly in the present phase of development. The present phase is a phase of recession and such carry-back allowance may very greatly warm up the flagging enthusiasm for new business. Usually, the carry-back allowance is considered to be of little value to new business. In case of India, however, it has a special significance. The Indian Independence just followed the cessation of the War, and with the spur of freedom many industries were started, and the war-time industries also continued to make good profit. This phase of good profit continued almost up to 1950 and then from the latter half of 1951, the phase of declining profits or no-profit started. The new industries have naturally paid tax even during their initial stages (after adjustments for 6 per cent. dividend). Such profits were earned under abnormal conditions and with the passing of that abnormal phase, the new industries have been put to great difficulty. Such allowance for carry-back of loss to these new industries at least for sometime may be very helpful.

As to the question of carry-back allowance in the case of cessation of business, the Chamber would recommend such a provision being introduced for a period of 5 or 6 years.

Question 75.—Payment of Advance Tax : Section 18A.

The justification for advance payment of tax on the principle of "pay as you earn" was much greater during the emergency of the War period, and in the peace time economy, and particularly in the present phase of declining profits, the provision is proving onerous for the assessee. Under the prevailing financial conditions, the Chamber would prefer repeal of this Section. In its opinion, this advance payment system has been affecting the speedy assessment, because the Income-tax Officers do not show much interest in assessment because of advance collections.

In this connection the Chamber would also suggest that Section 23B for provisional assessment should also be deleted from the Act. The existence of this Section seems to be also impeding speedy assessment. The administration has also been complicated by these advance payment and provisional assessment systems. The Chamber would strongly urge that the tax should be collected only on the basis of prompt assessments made on the completion of the final accounting of the assessee and the present method of payment of taxes at

three stages, viz., advance payment, provisional assessment and final assessment, is unduly complex and increases the cost of compliance.

Question 76.—Assessment under Section 34.

The present widened Section provides for assessment in four different cases, (1) Income which has totally escaped assessment by an act of omission or commission by the assessee, (2) income which has been under-assessed, i.e., where portion of the income has been left out in making assessments, (3) where the income has been assessed but at an "unduly" low rate, and (4) where the assessment has allowed relief which is considered "undue" or too liberal. While the Chamber appreciates that there must be some provision for roping in escaped income, it considers the Section to be too wide, keeping the assessee under the sword of Democles for 8 long years and 4 years even where the assessment was made but the Authority detected later on that too much relief was given or too little tax was charged. The Chamber would also like to observe that the volume of escaped assessment must have gone down now and the need for such wide powers applicable for 8 years need not be continued. Such a provision necessarily injects an element of instability and a scope of harassment in income-tax assessments.

In the next place, the Chamber would suggest that circumstances of excessive relief or application of too low a rate, if desired to be re-opened, should be re-opened within a period of one year and such privileges of re-opening for the assessing Authority should not be unduly long in comparison with the time that is given to the assessee for making appeals.

It is also to be considered that if the taxing Authorities are allowed to rectify the assessments, the assessee should also have some scope for rectification of the mistakes that may be committed by them in the returns or which they may find to have been committed by the Income-tax Officers in making the assessments.

At present the Taxing Authorities can reopen a case only if the Income-tax Officers has reason to believe that an assessee has escaped the assessment or has been under-assessed at too low a rate or has been granted excessive relief. This makes the position of the assessee very fluid. The Chamber would suggest that in cases of re-opening, the ITO's must give specific reasons for re-opening the case and these reasons must be intimated to the assessee.

Lastly, the heading of the Section, viz., "Escaped Assessments" should be changed, because the cases of under-assessment which are not due to any fault of the assessee, should be treated differently from the cases of escaped assessments.

Question 77.—Simplification of Procedure.

Complicated and delayed assessments affect the tax-payers' morale and keeps the assessee away. The Chamber would suggest that in case of Companies the certificates of the Chartered Accountants should be automatically accepted for assessment. The time lag between the provisional and final assessment should also be shortened and all delays in assessments should be avoided. It has been represented to the Chamber that usually the assessments are held up for 2/3 years and are somehow completed at the end of the limitation period. This creates a very bad impression on the assessee.

In case Section 18A is not repealed, and the assessee makes advance payment, there should be final assessment and not again a provisional assessment after advance payment of tax.

The Chamber also understands that in practice, Section 23B is applied only in those cases where the Income-tax Officers can demand more of tax over and above the advance payments that have been made in terms of Section 18A. In case where the assessee may obtain refunds the provisional assessments are usually not made.

Question 78.—Assessment Procedure and Appellate Tribunal.

The Chamber is strongly opposed to the suggestion that the Appellate Tribunal should have the power to enhance assessment in the same manner as the Appellate Assistant Commissioners. The Appellate Tribunal should be judicial authority and not an assessing authority. At most the Tribunal may order reassessment whether for reduction or for enhancement as they may deem fit. In spite of all improvements there is a feeling that 100 per cent. judicial attitude cannot be obtained from the Appellate Assistant Commissioners, ostensibly due to their affiliation to the Assessing Department. So, the association of the Appellate Tribunal with the work of assessment would be still more undesirable.

In the opinion of the Chamber, the Appellate Tribunal should rather be completely taken out of the jurisdiction of the Finance Ministry and should be put under the Ministry of Law.

Question 79-81.—Corporation Tax.

Basic Approach.

The questions are framed on the assumption of continuance of Corporation Tax. The Chamber would like to emphasise that the issues raised in the Questions should be examined on the back-ground of the weakness in the basic justification of the Corporation tax in the present stage of the country's development, particularly the paucity of the Company type of business in India. It must be conceded that taxation of Corporate bodies as such was introduced in the tax systems of other countries only after considerable progress in the formation of Corporations in those countries and when industrialisation attained a sizeable standard. There is no denying the fact that the Corporate income-tax has repressive effect on risk-taking, investment and economic expansion, and it also affects managerial decisions. The Corporate type of business organisation has not adequately progressed as yet and the double taxation element in the Corporation tax affects incentive for risk investments in Company shares. If a Company is taxed at say, 25 per cent. on its net income as Corporation tax, it must earn a little over Rs. 133 in order to have Rs. 100 for dividend. This means, that a Company must be able to have a 33 per cent. higher productivity with its share capital than an individual enterprise in order to achieve parity between the two. The Corporate income-tax works against share capital financing as compared to loan capital financing. It needs to be appreciated that a shareholder whose personal income may be assessable at a much lower rate or may not be assessable at all, thus gets inequitably taxed if he invests in share. Such a position seriously affects the propensity of the individual to invest in shares and at the present stage of capital formation and organisation of Joint Stock Companies, the Corporate income-tax should therefore be considered as unsuitable for India.

On considerations of Central revenue and facility of collection, if the tax is to be continued, however, then it needs to be kept very low, and the scheme of Corporation tax needs be planned so as to reduce its repressive effects to the minimum, particularly on the smaller and new companies which are also otherwise at a disadvantage to attract investment in their undertakings. The Chamber has, therefore, indicated in reply to Question 66(d) above that, if at all to be continued, the rate should not be higher than 0-1-6 pies in the rupee with exemption to all Indian Companies upto an income of Rs. 50,000 and in that case the Company rate of income-tax should not be more than as. 3 in the rupee.

Subject to these general observations, the Chamber would like to give their replies to the specific questions made in respect of Corporation Tax.

Question 79.—Progression in Corporation Tax.

The Committee are basically opposed to Corporation tax at the present stage of development of the corporate type of business in India. The Corporation tax is virtually an additional tax and there is much reason for its consolidation with the income-tax for taxation and necessary adjustments at the hands of the shareholders. Even if it is continued, the rate of the Corporation tax should be kept at a very low level not exceeding 0-1-6 pies in the rupee.

Secondly, all Indian companies, public or private, whose incomes do not exceed Rs. 50,000 should be exempted from the Corporation tax, even if the incomes of all Companies upto Rs. 50,000 are not exempted.

Barring this exemption, which would help the formation of new and smaller companies, the Chamber would not recommend any progression in the rate of Corporation tax.

The Chamber would also emphasise that progression in Corporation tax may unduly affect the middle-class shareholders of the companies.

The Chamber would reiterate that the argument of privilege of the joint stock companies justifying the imposition of Corporation tax does not appear to be expedient at this stage of development. Moreover, in countries like Canada where Corporation tax was introduced even before the Great War I, the tax was introduced purely out of revenue consideration. It was introduced in the U.K. during World War I, and was abolished during the post-war period. In Canada, Dr. Vineberg in writing on Provincial Taxation of Corporation Profits in 1912, observed that "the primary purpose, generally speaking, is to raise revenue, and all principles of equity are relegated to the background to make room for base of taxation which may even approximate justice."

In India, at present, there is an element of graduation in respect of super-tax on Company income (i.e., Corporation tax), in so far as the rebates are allowed to Companies declaring dividends within India and earning an income not exceeding Rs. 25,000, and to higher incomes also on fulfilment of certain other conditions. But these graduations are not applicable to

the private limited companies. This latter limitation has virtually made the graduation ineffective in so far as the promotion of the corporate type of business is concerned. It is to be conceded that in the initial stages of a business undertaking the promoters generally think of starting the company as a private limited one and after some progress is made it is converted into public limited companies.

As already mentioned, the Chamber would recommend differentiation only upto an income of Rs. 50,000 and no other differentiation among the Indian Companies.

Question 80.—Different Rates of Corporation Tax on Different Types of Corporate Enterprises.

On principle, the Chamber is opposed to the imposition of different rates of Corporation Tax on different types of Corporate Enterprises, provided the rate is kept very low as suggested before and an income of Rs. 50,000 is exempted from Corporation Tax.

Question 81.—Exemption of Inter-Corporate Dividends from Corporation Tax.

The Chamber would strongly urge for exemption of inter-Corporate dividends from Corporation tax. The tax treatment of dividends received by one Company from other companies should be considered fundamentally different from the question of taxation of dividends received by an individual from a company. Upto 1935, such inter-Corporate dividends were totally exempt from Corporation tax in the U.S.A. In Canada also such inter-Corporate dividends were exempt from Corporation tax in many of the Provinces levying Corporation tax. Even now in the U.S.A., when one Company receives dividend from another Company, the receiving Company is allowed a deduction of 85 per cent. of the dividends received.

The object of taxing inter-Corporate dividends is ostensibly to discourage the growth of giant Holding Companies of complex structure and it is also considered by some as an anti-monopoly instrument. At the present stage, the Chamber finds hardly any scope for development of such large holding companies in India. It therefore feels that inter-Corporate dividends of the Indian companies should be exempted from the burden of double taxation. To guard against the growth of an undesirable structure of holding companies, Company law appears to be a more appropriate instrument and that law is also now before the Parliament for thorough modification and overhaul.

Through the Finance Act for 1953-54, a provision has been added in the Income-tax Act (Section 56A) exempting the dividend received by a company from certain categories of industrial undertakings from super-tax. The Chamber welcomes the adjustment made by this provision but it feels that the principle should be extended to include dividends from any company without restriction on its registration after 31st March 1952. In the present form, this concession is not likely to be effective inasmuch as most of such new companies can hardly be expected to give any dividend in the present phase of business conditions in the country.

Question 82.—Taxation of Banks, Investment Companies and Insurance Companies.

(a) *Banks*.—The Chamber has already indicated some special facility that should be extended to the Indian Banks in respect of profits of their foreign branches, in reply to Question No. 59 above. The Chamber appreciates that there are certain special characteristics of Banks which differentiate them from other businesses and which requires special consideration for the purpose of taxation of Banking incomes.

Firstly, the Banks are regulated by special law and have to conform to the provisions of that law in respect of capital, reserve, etc. The Money and Credit policies of the Reserve Bank of India also directly impinge on the banking transactions and profits. Secondly, the Banks have to carry a stock of intangible properties and have to increasingly hold portfolio of Government securities. All these may warrant special treatment of banks in respect of dividend declarations, allowance for reserves, computation of incomes from properties, credit for shares held on blank transfers, dividends received from Companies, etc. In Canada, where Corporation tax has been in vogue, Banks have been all through separately treated under the Provincial laws and Corporation tax has been based on either paid-up capital or number of branches instead of on profits. The Commission may examine on more expert level about these points.

The Chamber would suggest specific provisions in respect of the following:—

(i) Amounts transferred to statutory reserve fund as required by the Banking Companies Act should be allowed for income-tax. This provision is necessary in the interest of healthy development of banks. Alternatively, the Commission should recommend amendment of the Banking Companies Act to compute net

profit for statutory reserve after deduction of the Corporation tax and Income-tax.

(ii) At present bad debts actually written off, are allowed as deductions under Section 10. In the interest of healthy development of banking, the banks should be encouraged to provide reasonable amount every year as provision for doubtful debts irrespective of the fact of their being bad debts. It is well-known that in the period of booms the banks made good profits and the bad debts are very few. If the suggested reserve for doubtful debts is allowed to be built up the bad debts in lean years can be met out of such reserve, without affecting the profits of the company which is likely to be allowed during such lean years. In case such reserves are found to exceed the actual bad debts during the period of say, 5 years, the balance standing to the credit of such reserve fund may be subjected to tax at the periodic interval of 5 years. Incidentally, it may be mentioned that in Japan 3 per cent. is allowed as provision against bad or doubtful debts. For this allowance Auditor's Certificate as to the quantum of doubtful and bad debts may be required.

(iii) Interest on securities should be taxed under Section 10 and not under Section 8 in respect of banks. At present no expenditure is allowed under Section 8 in computing the income from securities, excepting commission on collecting interest. It is to be conceded that the securities represent the stock-in-trade of the bank, and as such both income from securities and profit or loss in dealing with the securities should be taxed under Section 10 only. In this respect no distinction should be made whether the interest is received from tax-free securities or otherwise.

(b) *Investment Companies.*—The Chamber feels that organisation of *bond fide* investment companies may facilitate the investment in industrial shares by mobilising the savings of the smaller individual investors. In a way the investment companies may be expected to strengthen the base of industrial finance in the country, in the private sector. Special treatment of such investment companies is, therefore, warranted.

Firstly, the properties they hold are the stocks and shares which may appreciate in value and, therefore, in computing the income in any year such capital appreciations in the year of sale cannot be taken to be wholly the income of a particular year. The principle of averaging incomes for this purpose seems to be specially relevant in respect of the investment companies.

Secondly, these companies should be exempted from payment of super-tax in respect of dividend incomes which have already been taxed in the hands of the paying companies, even if the super-tax on companies is kept separate under the name of Corporation tax.

Thirdly, the incomes of investment companies are likely to be much more fluctuating and irregular than other types of business for which also averaging or at least quinquennial adjustments would be justified.

In respect of taxation of undistributed profits there should be no discrimination against the investment companies as was recommended by the Income-tax Investigation Commission. Such companies also require to maintain reserves for two reasons, namely, (a) for the purpose of equalisation of dividends; (b) to make provision against fall in the prices of shares or investments that may be held by the investment companies.

At present the Central Board of Revenue may specially recognise trust companies for tax concessions, but the Chamber is not aware of such recognition having been given to any trust company. The Chamber would urge for incorporation in the Act itself of some provision for recognition of trust or investment companies for the purpose of taxation.

Regarding the taxation of investment companies special provisions on the lines of Sections 257 to 264 of the Income-tax Act of 1952 of the U. K. may be examined.

(c) *Taxation of Insurance Companies, specially Mutual Companies.*—The Committee consider that the load of taxation on Life Assurance Companies should be substantially lowered, these institutions being really institutions aiding social security and capital formation.

Secondly, at present, differential rates of income-tax and super-tax on Proprietary and Mutual companies exist. According to the Indian Insurance Act not less than 92½ per cent. of the profits must be allocated to Policy holders. It would thus be found that even the Proprietary Life Assurance Companies in India are at least 92½ per cent. Mutual. The Chamber, therefore, feels that the balance of 7½ per cent. of the profits at the maximum, available to the shareholders should not be discriminated against. This little concession to shareholders of Life Assurance Companies would secure greater good for the Society by encouraging Life Assurance Business.

As to the taxation of the Policy holders share of the surplus, the Income-tax Investigation Commission recommended that under a "profit basis" of assessment, the bonus load should be excluded from the taxable quantum. At present, however, 80 per cent. of the Policy holders' share of surplus is only exempted in place of 50 per cent. exemption before. The Committee strongly feel that the policy holders' share of the surplus should not at all fall under the category of income, profits or gains, and as such should not be liable to taxation under Income-tax Law. In fact, in the United Kingdom also, the entire surplus distributed to or reserved for or allocated to the Policy holders is excluded from taxation.

In the next place, the Chamber would strongly recommend that the entire management expense should be allowed as deduction for assessment of Insurance Companies. The Income-tax Investigation Commission recommended only 15 per cent. of the renewal premium instead of 12 per cent. on account of management expenses and this has been given effect to by the Income-tax Amendment Act of 1953. Under the Indian Insurance Act, there is statutory limitation on expenses and it would be inconsistent if the expenses allowed under the Income-tax Act are different from those allowed under Insurance Act. The Committee would like to observe that when continuous supervision for enforcing the statutory provisions and for guiding the Insurance Companies, has been provided in the Office of the Superintendent of Insurance, it should be presumed that the expenses of the Companies are being regularly checked up by the Government. There should not be, therefore, any objection to allow deduction of the actual expenses incurred by the Companies. The Chamber understands that this is also the practice in the United Kingdom. If the Government be hesitant about the effectiveness of supervision of the Superintendent of Insurance, and therefore do not feel inclined to follow the British practice, the Chamber must urge that at least deduction for expenses should be the same as that provided under the Insurance Act.

The Chamber does not agree with the view of the Income-tax Investigation Commission that the profits that are distributed amongst the shareholders should be treated as standing on the same footing as profits made by any other company with the liability to even corporation tax. As has already been observed, Indian Life Assurance Companies are at least 92½ per cent. mutual under the present law and to put the balance of some 7½ per cent. of the income at the maximum under Income-tax and Corporation tax, at the same levels with other Companies would be inequitable for the shareholders.

Regarding the inter-valuation period also, the present Income Tax Act differs from the Indian Insurance Act as amended in 1950 in the matter of computation of profits. It is to be conceded that when inter-valuation period of Insurance Companies stands shortened from the previous 5 years to the present 3 years, unless the Income-tax Act is similarly amended, only 3/5ths of the tax deducted at the source during the preceding inter-valuation period of 5 years, would be given credit during the subsequent 3 years, with the result that 2/5ths of the amount will be lost to the insurers and the Companies will have to bear the additional burden.

In consideration of the vital importance of Insurance Companies engaged in business of General Insurance, in the country's economy, and particularly in the matter of earning invisible income for the Nation, it appears that special treatment may be also warranted for the General Insurance Companies in respect of their "foreign" incomes.

It is sometimes argued that in the public interest insurance companies require regulation and that involves additional expenditure on the part of the Government. Regarding this, it may be said that the Insurance Business have also to bear various other levies in the form of annual filing fees, Agents licence fees and several other imposts.

Question 83.—Differentiation of Distributed and Undistributed Profits of Companies and Section 23A of the Income-tax Act.

The Chamber is opposed to any differentiation between distributed and undistributed profits of Companies for tax purposes. The Chamber is also opposed to any notional distribution of profits as provided in Section 23A of the Income Tax Act.

The Chamber appreciates the need for ploughing back of Company profits for expansion and investment, but it feels that to realise this object, the load on Company profits need be lowered rather than a little concessional taxation of undistributed profits after imposing high taxes.

The Chamber has already suggested that the Corporation tax and the personal income-tax on Company dividends should be consolidated, and if this suggestion is accepted, the whole question of differentiation would assume a different significance. Even if the Corpora-

tion tax is continued, the Chamber has suggested the lowering of the tax to 0-1-6 pies in the rupee, and if this suggestion is accepted, then the Chamber would not support any differentiation in favour of retained profits. In fact the existing rebate system in respect of retained profits of some Companies is of recent origin in the Indian Tax system.

The undistributed profits of Companies are ultimately the incomes of the shareholders, and if such profits are taxed at a lower rate, then there is a clear discrimination against the profits earned by the proprietorship and the partnership enterprises which are taxed at the full personal rates irrespective of whether such profits are retained in the business or are distributed. Secondly, for normal functioning of the private sector, the profits should be allowed to flow to the hands of the shareholders for re-investment, and the investment market should be allowed to decide what should be ploughed back in the particular enterprise and what should flow in other enterprises. In this regard the taxation policy should remain neutral. Differentiation in favour of retained profits may not result in the best allocation of the investment resources, because the investments would not be tested in the free market of investments.

The Chamber agrees that the retained profits may sometimes be helpful for a Company to more easily secure the business capital which it may be difficult and expensive to acquire in the capital market. But it would be bad in principle to provide positive inducement for such retention by preferred tax treatment. The Chamber is not in favour of a tax policy being used as an instrument for allocation of resources in the private sector.

As the Chamber is basically opposed to preferential taxation of retained profits, the question of evasion of tax by retention of profits or the utilisation of such retained profits for productive purposes, does not arise.

The rebate system on undistributed profits was introduced in the Indian tax system only recently, principally as an anti-inflationary measure along with limitation on dividends and also to partially minimise the repressive effect of the high load of tax on Company profits. The Chamber feels convinced that the phase of profit inflation is already over and it presumes that the present Commission would definitely lower the load of tax on Company profits. It therefore does not find any further justification for differentiation in favour of retained profits. In the interest of private sector of the economy as a whole, such differentiation should not be made.

Section 23A of the Income-tax Act :

As has already been observed, the Chamber is opposed to any notional distribution of profits as provided by Section 23A. It therefore recommends deletion of the Section.

As far as the experience of the business community go, the operation of the Section has affected the financial decisions of the Companies. The Section unduly discriminates against the private limited Companies and the Chamber does not hold the view that such Companies are formed principally with the motive of evading tax. On the contrary, the Chamber would reiterate that enterprises are first constituted in the form of private limited Companies and then after some success, these are converted into public limited Companies.

In this connection the Chamber may mention that neither the British law nor the US law, wherein preventive provisions exist against retained profits, makes any statutory provision as to the arithmetical ratio of dividends which is notionally taken to have been distributed as is done by Section 23A of the Income-tax Act in India. In the USA, Section 102 of the Internal Revenue Code envisages penalty rates of super-tax on Companies that accumulate profits to prevent the imposition of super-tax upon the shareholders, and the accumulation of profits beyond the *reasonable* needs of business is considered to be a *'prima facie'* evidence of a purpose to avoid super-tax. But the penalty rates are imposed only after very careful examination of the *entire financial position of the Company*. In the U. K. Income-tax Act of 1952, various indicators of the needs of Companies are mentioned for measuring the adequacy of accumulated profits in Section 246.

Even if some provision on the lines of Section 23A is continued, it should be suitably amended so as to generally guard against the deleterious effect of the notional distribution of profits. In particular, the following points should be secured:—

- (a) In making a notional distribution, the amount of profit should in no case be taken to exceed the net profit shown by the Profit and Loss Account of the Company.
- (b) In no case, a Company should be deemed to have distributed as dividend more than 60 per cent. of the profits, irrespective of whether its reserves exceed the paid-up capital or not. In other words the first proviso to sub-section (1) of Section 23A should be deleted.

Question 84.—Super-tax on Company Dividends.

The Chamber has already suggested that income-tax and super-tax should be consolidated both in the case of the individuals and of the Companies. If this suggestion is accepted, then there would be no question of super-tax on Company dividends.

If, however, a Corporation tax of -1/6 pies in the rupee is levied in addition to an income-tax of As. 3 in the rupee, as alternatively suggested in reply to Q. No. 66(d) above, and if the rates are not consolidated even in the case of the individuals, then the Chamber would strongly urge that there should not be any super-tax on Company dividends, in so far as the Corporation tax would be there on the Company profits. The super-tax on Company dividends with Corporation tax on Company profits, means double taxation of Company incomes, and this affects investments in Company shares. In the opinion of the Chamber, such dis-incentives should be avoided.

Question 85.—Taxation of Public Undertakings.

In reply given to Question No. 11 in Part I the Chamber has suggested taxation of Public Undertakings of industrial and commercial nature at par with similar Undertakings in the private sector. This would enable better comparison of the relative efficiency of the public and private sectors. Secondly, the Central Exchequer in that case would also get revenue out of State Undertakings and the State Governments would also obtain some indirect taxes from Central Undertakings within their respective States.

It is apprehended that if the Public Undertakings continue to be expanded and if these continue to remain tax-free, then it would bring about re-adjustment in the finances of the Centre and the States resulting in further attempts on the parts of Governments to raise revenue by taxing the private sector to finance the expenditure of the Central Government.

Question 86.—Using the Services of Chartered Accountants in Assessments.

So far as the companies are concerned the services of the Chartered Accountants are being very widely used even now. The partnership firms and the proprietary concerns are also gradually using the services of the Chartered Accountants more and more. The Chamber is, however, opposed to any legal obligation being imposed on the assessee in this regard. The already existing trend for wider use of the services may be accelerated if the computations of incomes made by the Chartered Accountants and the certificates issued by them are given wider credence than at present. In the case of companies the auditors have considerable legal obligations under the Companies Act and, therefore, the certificates issued by them can be outright accepted without any question. In respect of partnerships and individuals also their certificates should be given equal credence.

In this connection, the Chamber would like to invite the attention of the Commission to circular No. 47 (XXIV-I), dated the 18th December 1952, whereby the Central Board of Revenue instructed the assessing officers that the auditors' certificates should not be taken to be sacrosanct and "should not be given more credence than the certificates of the assessee's own accountants". The Chamber appreciates the circumstances in which the circular was issued, namely that a particular auditor was found to be negligent in issuing the certificate in the case of a non-company assessee. In the opinion of the Chamber delinquency in one or two individual cases should not prompt the taxing authorities to issue a general circular like the one under reference.

In case a Chartered Accountant issues a certificate as to the taxable income of a non-company assessee, he may be deemed to have done it on the basis of the same code of conduct according to which he issues certificate to a company regulated by the Indian Companies Act. But there should be no obligation on the part of the assessee for compulsory certification of accounts or income-tax returns. This will very much impinge on the small businessmen and the cost of tax compliance may all the more increase.

On the whole, the Chamber is in favour of allowing the present trend to continue in the matter of utilisation of the services of Chartered Accountants.

Question 87.—Representation of Assessee by Income-tax Practitioners.

In the opinion of the Chamber the present provisions of Section 61 of the Income-tax Act appears to be sufficient in respect of representation of the assessee before Income-tax Authorities. At present representation is possible through any person authorised by the assessee in writing or by a lawyer or accountant or

income-tax practitioner, as described under Section 61. As to the question of fees the Chamber feels that any statutory provisions in this regard would be unsuitable for all the different categories and types of assessee. Even if such a schedule of fees is laid down it can hardly be made effective.

As to the level of proficiency the Chamber is of opinion that the existing provisions of the Act are sufficient to ensure a minimum level of proficiency on the part of the representatives in respect of the Income-tax law, rules and regulations. Regarding the question of conduct, the Chamber, therefore, does not consider already rules of conduct for the lawyers and the accountants, and for others sub-section (3) of Section 61 appears to be sufficient for maintaining certain rules of conduct. The Chamber, therefore, does not consider it necessary to have any separate statutory provision for registration of income-tax practitioners laying down the rules of conduct and schedule of fees.

Question 88.—Publication of the names of persons who are penalised for concealment of income.

In the opinion of the Committee publication of the names of persons 'penalised' for concealment of income is bad in principle and would be ineffective in assisting to check evasion. Concealment of income may be of various degrees ranging from so-called technical concealment of a very small portion of income arising out of the complexities of law itself to the total concealment for the purpose of evasion. Any statutory power for publication of the names of assessee in all such cases of concealment can hardly be justified on principle. In cases where assessee are criminally penalised in Courts of Law the proceedings are automatically published in the Court proceedings which may be available to any member of the public.

Unless the matter goes to Court and it is proved in a Court of justice that there has been really a concealment of income amounting to cheating of public revenue, there can be hardly any ground for a tax collector to defame a person by publishing the name of an assessee with the ostensible purpose of lowering his status in public eye. Secondly, if publication of such names becomes a routine in all cases of concealment of income then it can hardly have any effect, because it will be taken to be a feature of the income-tax administration. The income-tax Investigation Commission examined these issues and dropped the idea of giving wide publicity of the names of persons who are found to make gross under-statements of their incomes.

The concealment of income may arise due to delinquency prompted by economic inability to pay or out of an attempt to avoid tax by taking advantage of the loopholes of the law or out of attempts for evasion of the tax. A high level of taxation and manner of administration also induce avoidance and evasion. In the opinion of the Chamber all such concealments cannot be classed in the same category and it would be difficult in practice to make distinctions among the assessee for taking a decision whether the name should be published or not. The question of cheating is largely a matter of motivation which cannot be easily determined.

Question 89.—Exclusion of Perquisites.

In the opinion of the Chamber the present exclusion of perquisites from taxable profits cannot result in much loss of revenue. Provision for such perquisites becomes necessary in business and naturally can be classed as almost normal expenses of modern business. From the point of view of individual employee, however, these perquisites do not at present bring such benefit the monetary value of which may be considered to constitute any sizeable proportion of the income. In the opinion of the Chamber, therefore, perquisites as are provided by the Commercial Houses to their employees should be excluded from taxation both in the hands of the Companies and in the hands of the employees.

In factories which are mostly located outside the urban areas, the staff which are required to remain within the factory areas or nearabout have to be provided with quarters and while the company has to spend money after it the employee cannot be deemed to have received the income, as such quarters can hardly be said to have any rental value.

Secondly, under present conditions considerable amounts of money have to be spent through the employees for entertainments, publicity, conveyance, etc., and the amounts involved in such perquisites given to the employees should not be taxed.

The business houses have now-a-days also to spend considerable money for providing amenities to the staff like giving free lunches, free conveyance, etc., in order to provide better conditions of work and improve efficiency. Such expenses are normal expenses of modern business and should not be taxed.

Question 90.—Realisation of Tax from Companies under Liquidation.

In cases of companies under liquidation, there may be an obligation imposed on the Liquidators to bring the fact of the liquidation order to the notice of the Income-tax Authorities and on receipt of such intimation, the Income-tax Officers may promptly assess the due tax and appropriate notice may be served upon the liquidators of the Company. Thereafter, the Income-tax Authorities should rank as creditors like other ordinary creditors except in respect of the last one year's assessment regarding which the taxing authorities may be accorded preferential position. The Chamber understands that in respect of individuals there is priority given in respect of tax on bankrupts assessed. The Chamber is definitely of the opinion that the taxing authorities should not be accorded any preferential treatment for the entire tax dues if such dues relate to the income for more than one year before the date of liquidation.

The Chamber would also like to emphasise that the payment of dividends to the shareholders or the payment to the creditors should not be delayed due to any delay in the assessment of such Companies under liquidation. It should be enjoined on the Income-tax Officers to complete assessments of Companies under liquidation within a stated period.

Question 91.—Conferring of Wider Powers on Income-tax Authorities.

The Chamber considers that the Income-tax Authorities have even now enough powers in their hands to check evasion and avoidance and there is no necessity of any extension in their powers. As was observed in the Preliminary Memorandum of the Chamber, (Para 6) the effectiveness with which a tax law is enforced is one of the principal determinants both in respect of yield and equity of taxation measures. The administration of a tax system must be a two-pronged operation, the operation of the tax administrative machinery of the Government on the one hand and the attitude of the tax payers in respect of tax compliance on the other. The Chamber considers that any large discretionary power in the hands of the Income-tax Authorities is fraught with danger of affecting the tax payers' morale. Tax Payer equity requires that tax administration should be executed as objectively as possible and the powers should be so given that there may be as little scope as possible for favouritism, arbitrariness or harassment.

The Income-tax Investigation Commission examined this question of extension of powers of the Income-tax Authorities and made certain recommendations to which the Chamber is definitely opposed. For example, the Commission recommended, (1) that the Income-tax Officers should have discretionary powers to call for total wealth statements and (2) to deal effectively with persons suspected of having blackmarket dealings, (3) to enter business premises and inspect accounts maintained therein, place identification marks thereon and make copies therefrom, (4) to make a search of places where there are reasonable grounds of believing that relevant books and records are kept, (5) to call for relevant information from Banks and other business houses, etc. In the Income-tax Bill of 1951 also, certain provisions were made more or less on such lines. The Chamber would like to stress that most of these powers are powers of the Police and powers of the Court. (In so far as the Income-tax Bill 1951 provided for empowering the Income-tax Authorities to issue commissions for examining witnesses and to enforce attendance and examine on oath, etc.) The taxing authorities must not be vested with such powers which relate to the civil liberties and fundamental rights of the people.

As to the question of seizure of documents and books of accounts, or powers of search as particularly mentioned by the Commission, the Chamber would strongly suggest that such powers should not be given to the Income-tax Authorities without the previous sanction of a Court of law. Even in that case, the books and documents must not be seized and kept, as this would impede the very earning of income which is the basis for taxation.

The Aiyar Committee of 1937 observed that the "fairly general complaint that the Income Tax Officers do not show enough consideration for the convenience of the assessee is certainly not without foundation", and the Chamber would request the Commission to seriously consider whether any further extension of powers in the hands of the taxation authorities would in any way improve matters.

Question 92.—Creation of Artificial Legal Entities for Avoidance of Income-tax.

Theoretically speaking, it is true that if the load of average taxation on individuals become very high, relative to the load on corporate bodies, then there may be a tendency to create artificial legal entities of various

types. But, the Chamber feels that there is no cause of apprehension at the present for any large increase in the creation of such separate legal entities primarily with the object of evasion of tax. The progress of Corporate types of business in this country would amply prove that there are too many impediments on the way of forming Corporate bodies and if the tax differentials are rationalised there is not likely to be much inducements as hinted in the question.

Moreover, the Company Law is being revised and appropriate measures are likely to be provided to check any large concentration of business in a few hands in the shape of closely held Corporations or what may be called "personal or family holding Companies".

Regarding the question of family partnership, the Chamber considers that family has ever constituted the unit of production in this country and in the opinion of the Chamber, too much impediments need not be created on various counts to disrupt this social institution. Already it has been disrupted by a variety of factors and the Estate Duty Bill recently enacted would further accelerate the disintegration. The apprehension of tax avoidance therefore, through these family partnerships seems to be unwarranted.

Regarding trusts and private limited Companies also, the Chamber would like to say that the purpose of organising such entities may be more than one and it need not be unduly apprehended that everybody would feel induced to take up this type of organisation only for the purpose of avoiding the tax. On the contrary, private limited Companies, Trusts and Family Partnerships should be welcomed as institutions for encouraging Corporate types of business by collective effort. With an undue apprehension for tax avoidance, the growth of these desirable institutions should not be impeded.

The Chamber holds the view that if penalising taxation is brought into the taxing system in respect of the Corporate entities mentioned above, it would impede the growth of Corporate types of business in this country and would not be to the interest of the country. Even if such penalising taxation is introduced it would be very difficult to decide whether such a separate legal entity has been organised with a motive for tax avoidance or for other purposes. The controversies would always be there.

Lastly, the Chamber considers that the issue raised in this question can arise only when large concessions are given in respect of taxing the retained profits of the business and the Chamber presumes that this question is based on an idea of substantial reduction in the taxation of undistributed profits.

Question 93.—Recovery of Unrealised Tax from one Partner from the Firm or from other Partners.

The Chamber considers that the present provisions of Section 26 of the Income-tax Act involve sufficient liability on the co-partners in cases of any change in the constitution of the firm and succession. The Chamber is of the opinion that any extension in the liability of the partners in respect of unrealised tax of any one partner, would make the partnership business too risky. Moreover, it should be considered that though the liability of the partners in a partnership firm is joint and several, these liabilities are only in respect of those incurred in connection with normal business. In no case, therefore, the liability for unrealised tax of any partner can devolve either on the firm or on any of the partners in respect of those incomes earned by such partner outside the business.

Question 94.—Recovery of Income-tax and a separate Enforcement Machinery.

The Committee consider that the present provisions in the law for recovery of income-tax are quite sufficient and there is no need for a separate machinery for realisation of the arrears. The Chamber believes that the pending arrear collections of past years have sufficiently declined by this time and with better and prompter administration in future, the arrears would be small in number.

(The Indian Income-tax Investigation Commission in para. 412 of their Report suggested for a system of examiners and for staggering methods along with improvement in return forms, etc., so as to diminish the arrears. The Chamber does not consider these to be necessary.)

Question 95.—Tax Collections from the Shareholders of Private Limited Companies in respect of Tax realisable from the Companies.

The Chamber considers that if the liability for payment of tax assessed on private limited Companies be imposed on the shareholders of such Companies, then that would mean the very negation of the idea of limited liability attached with such companies. As the Chamber has already pointed out in Question No. 92 the Private Limited Companies should not be too much suspected in consideration of their need for prompting the development of Indian trade and industry on Corporate lines. The Private Limited Company type of organisation have de-

finite advantages particularly under the present conditions of India. The Chamber considers the apprehensions of loss of revenue through formation of private limited companies as rather over-magnified. It would also like to reiterate that the Company Law is being revised and provisions may be made there and the Income-tax Law again need not take upon itself the task of impeding the growth of private limited Companies. It is therefore opposed to the suggestion made in the Question for imposing tax liability on the shareholders of a Private Limited Company for the liabilities of the Company.

Question 96.—Recovery of Tax from Profits in the hands of a person other than the ostensible Owner.

The Chamber is of opinion that the property should be assessed only in the name of its rightful owner. The question whether the ostensible owner is the rightful owner can be decided only by a Court of Law and the Income-tax Authorities should not take upon themselves the responsibility of deciding this question. But if the Income from any property is once included, in the income of a person other than the ostensible owner, and the assessment has been completed, no additional provision should be made for making the tax recoverable from such property again.

Questions 97.—Improvements of Public Relations.

As was explained in the preliminary Memorandum of the Chamber, the improvement in the relations of the Income-tax Department with the assessee can have significant effect not only on the realisation of the tax but also on the tax payers' morale regarding tax compliance. Much would depend upon the attitude with which the assessing Authorities look upon the assessee. One of the greatest hinderance appears to be that there is a feeling among the taxing authorities to consider every assessee as a tax evader and then to feel convinced that he is not so. The presumption is thus against the assessee. In the opinion of the Chamber, the first pre-requisite for better relations is to change this attitude. Each Income-tax Officer must start with the assumption that the tax payer's return is correct and there is no intention of evasion and he should proceed with this idea till it is proved otherwise. The conduct and behaviour of the Taxing Authorities should also provide no scope for creation of a feeling that the assessee is not being properly treated. The assessments must not be such as may provide the least scope to the assessee to feel that these had been capricious, or hurried.

The Chamber is strongly opposed to the present practice of the Income-tax Officers to proceed to levy tax on the basis of estimates of income made in an haphazard and arbitrary manner, without giving credence to the Books and records of the assessee. It has been experienced by the assessee that incomes are assumed for them and taxes are levied which bear no relation to actuality. The rejection of the accounts of the Private Limited Companies, Contractors, etc., has become almost a fashion with the Income-tax Officers.

The recent posting of Public Relations Officers appears to commend adequate confidence so that the assessee may look upon them as dependable guides without any risk.

Regarding the specific measures mentioned by the Commission, the Chamber's views are indicated as under:

Provision for free advice to small assessee: If effective and sympathetic advice can be given regarding the maintaining of account and filling in of returns, so as to facilitate expeditious disposal of assessments, it would greatly improve the tax payers' morale and may also reduce the cost of tax compliance particularly in the case of small assessee. On the question of maintenance of accounts, however, it should always be kept in mind that the large majority of the Indian businessmen particularly those who are carrying on business on medium and small scales, are not practised to organised methods of English accounting. They maintain their accounts in indigenous ways and in different forms. While giving advice for maintaining of accounts in some standard forms, no undue haste be shown for such standardisation of accounts. The accounts maintained by the assessee should be acceptable, while advice for making modifications so as to help expeditious assessments should be given. Gradually, the accounts would get standardised. The present return forms circulated by the Income-tax Authorities with guidance for filling in those forms is considered by the Chamber as a move in the right direction.

Regarding Refunds, the Aiyars Committee of 1937 observed that "the general attitude of the Officers of the Department to refund claims leaves much to be desired". The Chamber considers that this observation stands even now to a considerable extent.

On the question of *provision of information on various matters* relating to assessment proceedings, refund applications, adjournment applications etc., it appears that the present procedures do not require much change excepting that such information should be available to the assessee without any hindrance and much expense.

Regarding the question of arrangement of work, it appears that it should be ensured that the assessee or their Representatives are not to wait for unduly long periods at the Income-tax Offices. There should be weekly and daily programmes of work and in case when a particular assessment cannot be undertaken on the previously appointed day, the assessee should be informed just on appearance and at the appointed hour so that he may not have to wait to know at the end of the day that his case cannot be taken up.

On the question of agreement on facts between the assessee and the Department at Income-tax Officers level, the Chamber considers that this would largely depend upon the framing and the wordings of the law and the rules. The more these can be made objective, the less shall be the scope of difference of opinion about facts even. The difference largely arises because of ambiguities in the law and the rules. It has also been experienced that the Income-tax Officers are not always posted with the facts in the business and therefore cannot agree with what the assessee may say. To obviate this difficulty, the advice and guidance of the Senior Officers should be more readily available and it may also be considered whether responsible men having knowledge of business conditions and facts may be associated in any manner with the Assistant Commissioners for consultation about facts.

Question 98.—Procedural Changes.

(i) *Issue of Notices.*—The Chamber considers that the present provisions do not require any change. The Chamber would, however, like to mention that in the Amendment Bill for 1951, there were provisions for serving notice on any member of the Hindu Joint Family or on any shareholder of a private limited company in respect of the assessments of the family or the Company. The Chamber considers that any such provision would be unjustified in so far as any member other than the Karta in the Hindu Joint Family is not in charge of management and in the case of a private limited Company the shareholders can in no wise be expected to be aware of the day to day position of the Company. Moreover, under the provisions of the Company Bill introduced in the House of the People, every private limited company shall compulsorily have at least two Directors. Therefore, a notice should be served on such Directors or the Principal Officer of such Company.

(ii) *Simplification and filing of Returns.*—As already mentioned, the recent return forms appear to be simpler than previous ones. Regarding filing of returns, the Chamber generally agrees with the recommendations made in paragraphs 196-200 of the Report of the Income-tax Investigation Commission.

(iii) *Penalties.*—About penalties, the Chamber agrees with the Income-tax Investigation Commission that persons who do not submit their returns should not be disentitled from claiming statutory reductions of certain kinds as any automatic penalty of the kind would operate inequitably. The imposition of the penalty should be applied very judiciously as was recommended by the Income-tax Investigation Commission and all encouragement should be given to honest defaulter to come forward and get himself assessed and with this object in view, the penalty should be leniently applied. The Chamber should also like to mention that penalties under the Income-tax law should be kept limited to fines only.

(iv) *Recovery of Tax already paid.*—The Chamber considers that the provisions in the law for recovery of the tax are quite adequate in respect of all sorts of delinquencies, avoidances and evasions. The real difficulty in recovery arises from delay in assessment, and sometimes in the intervening period the tax paying capacity of the assessee undergoes vital change making it impossible for him to make the payment when the assessment is completed. The Chamber believes that tax collection can be much improved by reasonable and prompt assessments than by anything else.

(v) *Appellate Procedure and Machinery.*—The Chamber would reiterate that the Appellate Assistant Commissioners should be dissociated from the Income-tax Department so that it may be possible for them to take more judicial views than at present. In spite of the fact that Government still seems to hold that the Assistant appellate Commissioners have been showing commendable degree of judicial attitude, there is a feeling among the assesseees that it is not practically possible for them, considering such Officers to be after all, human beings having in them a desire for improvement of their prospects in the Department.

Question 99.—Undue Delay in Assessment.

The Chamber has often brought to the notice of the Income-tax Authorities that undue delays are made in the assessment proceedings. It has been found that assessments are delayed for 3 or 4 years and at the end of the limitation period, assessments are rushed through, which appear to the assesseees to be capricious.

The Chamber is not in a position to give any authoritative opinion as to the exact reasons for which such delays are made. It appears that the Income-tax Officers for one reason or the other, do not exhibit much eagerness to complete the assessments in time and sometimes it also appears that they feel to be shaky in taking decisions about acceptance of facts as stated by the assesseees. This may be due to the lack of knowledge and facts as also to the fear of being Departmentally rebuked. In the opinion of the Chamber, the rules and orders should be made clear and objective and greater confidence should be shown by the Income-tax Officers in completing assessments promptly according to his best decisions. Even if such assessments leads sometimes to improper assessments, whether from the point of view of the assessee or of the Government, there may be adequate provisions in the law for revision and review at the initiative of either party.

Question 100.—Excess Profits Tax or Special Business Taxes.

In the opinion of the Chamber, Excess Profits Tax can never be looked upon as a feature of peace-time taxation. In other countries also, this complex type of tax has been brought into existence only in abnormal times of War or semi-War emergencies. The idea of excess profits is a relative idea and it is always difficult to decide what may be considered as excess at any particular point of time. In the USA, this tax was practised during World War I and World War II but on the expiry of the War emergency, the tax was abolished. After the Korean War again, the tax was re-introduced in 1950. The basis for such taxation is "invested capital" method or "base period" method. But under both these methods, innumerable difficulties have been experienced with the result that just on the expiry of the emergencies the tax had to be given up. In this connection the Chamber may just quote the observation that was made by the Secretary of the Treasury of the U.S.A. Government in his Annual Report for 1920 in respect of Excess Profits Tax of 1917-18. The observation was—"the tax does not attain in practice the theoretical end at which it aims. It discriminates against conservatively financed organisations and in favour of those whose capitalisation is exaggerated; indeed many over-capitalised Corporations escape with unduly small contributions. It is exceedingly complex in its administration, despite the fact that it is limited to one class of business concerns—Corporations".

The Chamber has strong objection to the introduction of any tax like Excess Profits Tax in a peace-time economy. This tax acts as a disincentive for risk-taking and expansion, it penalises the firms with fluctuating profits, and it interferes with the very function of profits in stimulating the flow of investment.

The Chamber is opposed to any special business tax.

Questions 101 & 102.—Death Duties.

Though the Estate Duties Act has been made effective, the Chamber would like to reiterate that this measure of taxation has been most inopportune at the present stage of development.

The Chamber is not in favour of any differentiation in the matter of the rates chargeable on self-acquired property and property forming the Estate of the deceased. In the opinion of the Chamber such differentiation would be complex and in cases it may be found almost impossible to decide which portion of the property left by the deceased was inherited and which portion acquired.

PART III.—COMMODITY TAXES.

IMPORT DUTIES.

Question 103.—Revision of Indian Customs Tariff.

In the opinion of the Chamber, the Indian Customs Tariff Schedules, both Import and Export, require revision, for reasons indicated in (ii), (iii) and (iv) in the question.

The Chamber emphasised the question of revision of the Indian Customs Tariff Schedules with Shri P. M. Mukherjee, who was appointed by the Government of India during 1952-53 as a Special Officer for undertaking revision of the Import Trade Control Schedule. The Chamber would recommend that an independent enquiry should be undertaken about the work of revision in details, when suggestions as to the classification and the nomenclature of the specific items should be invited from all commercial interests.

At present, the Import Tariff Schedule is divided into 22 Sections with 87 broad Groups, the different Groups being again sub-divided into a large number of sub-Groups. The sub-divisions and the nomenclature are often broad and do not conform to the present pattern of trade.

Particular problems arise in respect of the classification and nomenclature of the protected items. When an industry is protected, by a high rate of duty, some particular products of such an industry may not be manu-

factured in the country but the duty becomes applicable to all such items also. By way of illustration, it may be mentioned that Outboard Motors and Petrol Powerine Engines of below 7 H.P. at present come under the same item as Diesel Engines in the Schedule. But these two specific types of engines are not manufactured in the country and are being at present considered to be very useful for development purposes especially for remoter areas. Similar observations may be made in respect of items like Ball Bearings, several Motor Vehicles parts, Machinery parts, Chemicals, etc. Extreme difficulties are being experienced in respect of classification of mixed woollen fabrics wherein the descriptions of the items do not conform to the changed practice of manufacture in the supplying countries. Similar difficulties are also experienced in respect of Paper items, Spindle oil etc.

In the Export Tariff Schedule also, difficulties are experienced in respect of the classification of articles like Khaki Water Proof Cotton Canvas, Hospital Rubber Sheetings with textile base, etc.

At the present moment, the Import trade has become much wider in respect of commodities and the Customs Tariff Schedule should be suitably adapted to the changed pattern.

The lacunae in the classification and nomenclature in the Customs Tariff Schedule also affect the administration of Import Control and the merchants are put in an embarrassing position.

Question 104.—Considerations for Fixation of the Rates of Import Duties.

(i) By and large, the rate of Import duty depends upon the nature of the product, its importance in the industrial development of the country, its availability within the country, the nature of the demand for the product etc.

At the present stage of economic development, it seems that Import duties shall have to be relied upon for the purpose of revenue and therefore, the above considerations have to be adjusted to the revenue consideration also.

Generally speaking, the rate of duty on industrial raw materials, plants and machineries and the spare parts which are not manufactured in the country, should be kept low, with drawback arrangements in case the products made out of such imported raw materials are exported out of the country. In case certain materials subjected to revenue import duty are consumed by industry as also by others refund may be given to the consuming industries.

The duties on luxury consumption goods should be higher, but it should not be made prohibitive so as to stop the import altogether. By way of illustration, it may be mentioned that import duties on a large number of items were increased very high early this year, and in several cases imports have not been possible with such high rates of duty. For example, the duties on cotton fabrics falling under Item 48(3) etc. were steeply increased with the result that in spite of liberalisation of the Import Control Policy, it has not been possible to effect import because of the high load of taxation.

Regarding duties that are imposed for protecting an indigenous industry, the Chamber would prefer to reply on the Tariff Commission in specific cases and such protective duties should not be applied on those specifications of the items, the manufacture of which are not immediately undertaken by the indigenous industry.

(ii) In the light of the considerations indicated above duties on items like Outboard Motors, Powerine Engines below 7 H.P., Ball Bearings and Motor Vehicles parts which are not manufactured by the indigenous industry, should be lowered in the interest of the industries consuming or using these articles. The duty on raw materials like Plastic Mould Powder is required to be lowered enabling the Plastic Industry to develop export markets on competitive lines. The Committee also feels that the principle of allowing "Token Imports" in order to promote improvements of quality of the indigenous products would get impeded if the rates of duties on items of such token imports are kept at the increased level to which these were raised early this year. The cases of cotton fabrics and manufactured cotton goods, artificial silk piecegoods, woollen manufactures, etc. would fall in this Group. Similarly, the present high rate of duty on Betelnuts which has been working to be roughly 100 per cent. of the value of the goods, should be lowered in the interest of the consumers.

(iii) It appears that high Import duties on articles like Betelnuts which are available in Pakistan provide incentives for smuggling. A high duty on articles which carry high value in small bulk may also provide incentives for smuggling and such smuggling puts the *bona fide* trade to disadvantage. It is true that smuggling cannot be justified nor should the duties be lowered simply on the apprehension of smuggling if there is other good reasons for high duty. But the Chamber feels that

the fact has to be faced, and the Import duties on the products of the neighbouring countries should be fixed with an eye to the possibility of smuggling because of high duty. In this connection it may also be mentioned that even if Export duty is continued on several items, fixation of the duty at a high rate may provide strong incentives for smuggling the goods out of the country to the neighbouring States, if these goods have ready markets there. There were complaints about such things in respect of cotton textiles when the rate of duty on the different qualities was kept high at 25 per cent.

(iv) No comments.

(v) As have been mentioned in reply to (ii) above, the rates of duties on several semi-luxuries, the imports of which were partially liberalised in early 1953, may be said to be yielding diminishing returns, especially because the Importers have not been utilising the permission for imports because of the high rates of duties. It may be difficult, however, to fully assess the position, as most of these items have been subjected to strict import control during recent years and there have been increase in indigenous supply also in several cases.

Question 105.—The Relative Merit of *Ad Valorem* and Specific Duties.

The issues involved in the relative use of *ad valorem* and specific duties in the Indian Customs were thoroughly examined by the Fiscal Commission of 1921-22 (*vide* Chapter XIV) and the Fiscal Commission of 1949-50 also referred to this examination by their predecessors.

The Chamber generally agrees with the analysis of the Fiscal Commission of 1921-22, regarding the comparative advantages and suitabilities of *ad valorem* and specific duties in respect of import tariff. That Commission recommended that "while the Indian Tariff must continue as at present *ad valorem* and specific duties and tariff valuations, the system of specific duties and tariff valuations might be extended cautiously".

The Chamber would not recommend much extension of specific duties without greater elaboration of the Customs Tariff Schedule in terms of grades, qualities and varieties of the items. Specific duties would not be suitable for those items wherein such specification of the different qualities and varieties may not be possible.

The Chamber is aware that in a phase of falling prices *ad valorem* duties may be advantageous to the trade, but it would like to stress that the application of *ad valorem* duties creates two difficulties for the importer, viz., (a) it brings in an "undesirable character of speculation to import transactions," if the rate is not applied on the basis of tariff valuations, (b) difficulties arise in respect of the assessment of the value on which the rate is to be applied in cases where there is no tariff valuation. The Chamber would therefore, recommend tariff valuation on a more objective basis as indicated subsequently, in respect of all possible items where *ad valorem* duty is per force to be applied.

Regarding protective duties, the Fiscal Commission of 1949-50 recommended that "the system of *ad valorem* duties would seem to offer the best guarantee of protection to indigenous industries". The Chamber generally agrees with this view, but would recommend automatic tariff valuations of the items wherever possible. In respect of revenue duties also, the Chamber would state that it is in favour of the extension of tariff valuation method on objective standards for the purpose of application of *ad valorem* duties. The application of specific duties in unavoidable cases and *ad valorem* duties on the basis of tariff valuations generally, would contribute more to the stabilisation of the Government revenue, and trade contracts.

Question 106.—Assessment of Duty on the Basis of Tariff Values.

(i) & (ii) The Fiscal Commission of 1921-22 examined the question of tariff valuation for the purpose of Customs duty in Para. 273-274. The Chamber considers that use of tariff values (wherever possible) as the basis of assessment of Import duties in respect of those items for which *ad valorem* duty is used, would be better than relying on "real value" basis. The Chamber would generally prefer extension of the tariff valuation scheme in all possible cases where *ad valorem* duties are to be imposed.

(iii) As to the method of determining the tariff valuation, the Chamber is not satisfied with the present procedure. At present the provisional tariff values are annually determined by the Director General of Commercial Intelligence & Statistics and before finalisation the Chambers of Commerce at the ports are taken into consultation. In a communication to the Chamber this year, the Director General explained that the provisional tariff values are determined "on the basis of ex-duty average wholesale market monthly prices at the main importing centres in India during the twelve months ending June weighted by the relative importance of the trade in each particular article in each of the principal

importing centres and modified, where necessary, in consideration of the proposal made by various Collectors of Customs and Central Excise Authorities in India, and also in consideration of the probable future trend in prices." It would be clear from this explanation that too much of subjective elements are brought into the picture and therefore the Chamber feels that the fixation of the tariff values under the present procedure has become a matter of compromise and almost a gamble in estimates.

It would suggest that the basis should be more objective and in this regard the *automatic* valuation method suggested by the Fiscal Commission of 1921-22 appears to merit careful consideration. Under this Scheme, the tariff values are to be automatically fixed every year on the basis of the prices of the preceding 2/3 years, and the Government should publish the monthly prices which would afterwards form the basis for the valuation. The Chamber generally endorses the observation made by the Fiscal Commission of 1921-22 "that a scheme of this nature goes so far in the direction of combining the advantages and minimising the disadvantages of specific and *ad valorem* systems that the Tariff Board might be directed to examine the feasibility and desirability of the extended use of a system based on this principle".

Question 107.—Fixation of "real value" under Sea Customs Act.

Under Section 30 of the Sea Customs Act, the "real value" for the purpose of assessment would be the wholesale cash price less the trade discount for which the goods of the like kind and quality are sold or are capable of being sold at the time and place of importation or exportation as the case may be, and "without any abatement or deduction whatever of the amount of the duties payable for the importation thereof" or where such price is not ascertainable, the costs at which the goods of like kind and quality could be delivered, or the landed cost. In the opinion of the Chamber, the Fiscal Commission of 1949-50 rightly observed that there may be administrative problems involved in the appraisal of value for Customs purposes. It has been experienced that sometimes difficulties are created by putting values at arbitrary figures and assessing the duty on the basis of such values. For example, if a merchant buys certain article on forward contract basis, at a time when the prices were low in the supplying country, and subsequently when the goods are shipped or arrive in India, the market might have gone higher, the Customs have been found to disbelieve the lower invoice price and have attempted to put the higher market price in India or the reported market price on the date of shipment in the supplying country, as the "real value" of the consignment. This really cuts against forward contract which would be naturally very common with the gradual stabilisation in international trade.

In the opinion of the Chamber, therefore, automatic tariff valuation method on the basis of published monthly prices as suggested before would be better. If the prices of the imported items are collected monthly and are published, then these being known to the Importers that in case of doubt the ruling price on the date of the contract or shipment may be used as the real value, the tendency for under-valuation would be conquered. Even where fixation of "real value" would be necessary, if the landed cost is not relied on, the market price in India and in the supplying country on the date of contract and not on the date of shipment should be used for determination of the "real value".

If the automatic tariff valuation method mentioned before is adopted, that would counter the tendency and scope of deliberate under-valuation to a large extent. In respect of residual items, tendency for under-valuation may be there only in cases where there is no tariff value and where the Import duty is very high.

The methods of valuation for Sea Customs Act if modified on the lines suggested above, would also be suitable for land customs. Moreover, as the Chamber has suggested above, the rates of duty on items which pass through Indo-Pakistan border may be kept lower and in that case, the tendency for evasion on the part of the trade would be largely minimised. But fixation of such differential rates of duty seems to involve many other considerations and the Commission may examine the feasibility of this suggestion. The Chamber would also suggest collection and publication of monthly prices of items which pass through such borders and in that case, the subjective element in the valuation would be less.

Question 108.—Special Exemption or Reductions in Import Duties.

(1) Re: Raw materials used by essential industries, the duty should be low and in case the products made out of such raw materials are exported, refund should be granted expeditiously. Provision for such refunds have been made by the Ordinance promulgated in October, 1953, by the President of India.

(2) Some provision for refunds on materials used for scientific research should be made. By a Press Note issued on 20th August 1953, the Government have declared to consider such refunds on *ad hoc* basis. It is restricted to materials supplied free to Government Research Institutions. This should be extended to other Research Institutions also, maintained in the Private Sector.

(3) It may not be administratively feasible for giving special exemptions or refunds on materials imported for charitable and humanitarian purposes, because there may be evasions through it and the established trade may be unduly affected through such loopholes. In exceptional circumstances only, the Government may give such refunds after careful examination of each case on merits.

(4) The Import duty on materials imported for approved development schemes, if made with the specific prior permission of the Government, may be refunded partially in order to lower the costs of such development. But such refunds should be available for the schemes both in the Public and the Private Sectors. Such refunds may be made in terms of Section 23 of the Sea Customs Act.

(5) *Necessaries of Life*.—It would be difficult to distinguish between essential necessities, conventional necessities, semi-luxuries and luxuries and therefore the Chamber feels that excepting foodgrains, exemptions or refunds on necessities may not be possible.

Question 109.—Sacrifice of Revenue for Bilateral or Multilateral Fiscal Arrangements such as G. A. T. T.

Except in the case of Pakistan, Ceylon and other neighbouring countries, on which India may have to rely for selling many of her manufactured articles, it is not likely to be advantageous to sacrifice much revenue in the interest of bilateral and multilateral arrangements such as G.A.T.T. or Commonwealth Preference. In such agreements, however, revenue cannot be the major consideration. Generally speaking, it appears that the concession received in respect of India's exports have not proved very advantageous to this country when related to India's export trade. The value of the exports covered by the direct concessions received in respect of India's exports constituted 18 per cent. of the total value of exports from the country in 1947-48, 12 per cent. in 1950-51 and only 13.5 per cent. in 1951-52. The value of exports to countries covered by direct and indirect concessions was 28 per cent. of the total value of exports from India in 1947-48 and it dropped to 22.4 in 1951-52. These show that India's exports to signatory countries did not increase during the years of operation of the G.A.T.T. Various industries are also coming into existence in India and are progressing, and therefore at this stage it may not be feasible to enter into long commitments in respect of giving concessions regarding Import duties. It has been observed that in respect of certain types of Ball Bearings and Provision Items, Tallow, Lithophone, Dyes and Coal-tar and Coal-tar Derivatives, certain Drugs, etc. the present commitments in respect of Import duties are proving disadvantageous to indigenous industries.

The Chamber would reiterate that special customs tariff arrangements may be entered into with Pakistan and other neighbouring countries provided similar concessions are received from them in respect of India's exports. In this connection, the Chamber would invite the attention of the Commission to the recent action of the Burma Government who have abolished all preferential tariff in favour of Indian articles.

Question 110.—Import Duty versus Import Quota as measure of Protection.

The Chamber would generally prefer the use of Customs duties to restrict imports, rather than quota system. From early 1953, Import Policy has been liberalised in respect of a number of items and the rates of duties have been increased. The Chamber prefers this policy.

In respect of non-protected items import quotas may be used only on considerations of foreign exchange and on a short-term basis.

The issues involved in this question were examined by the Fiscal Commission of 1949-50 and the Chamber agrees with the Fiscal Commission that for purposes of protection customs tariff should be more relied on than Import Control. Every measure of import restriction provides an indirect protection to indigenous industries. But it should not be looked upon as the principal lever for protecting an indigenous industry. The Fiscal Commission rightly referred to the question that quantitative restrictions sever the connections between the price levels of the home country and the outside world, introduces an element of rigidity in the balance of payments and tends to increase Government interference in foreign trade. Moreover, in the case of quantitative restrictions the profits from the resulting increase in internal price of the article goes to a few private individuals whereas under

restrictions emanating from Customs duties the benefit of the resulting increase in prices goes to the Public Exchequer.

Question 111.—Use of 'drawbacks' and ware-housing to assist export of manufactured goods involving use of imported raw materials.

The Fiscal Commission recommended the use of drawbacks on imported raw materials for assisting export of manufactured goods. The Chamber welcomes the recent legislation in this regard and it would emphasise that such drawbacks should be given most expeditiously and irrespective of whether such raw materials might have been imported directly by the manufacturers or might have been purchased in the internal market from the trade.

Question 112.—Administration of Sea and Land Customs Act.

Under the present law, the classifications of items under the Customs Tariff can be legally made by the Appraisement Authorities only after the landing of the goods and the pre-classification that may be made by them on the request of the importers have no legal validity. In the opinion of the Chamber, such pre-classification should be binding on the Customs authorities in cases where the articles have accepted standards or trade marks, or where the importer may deposit with the Customs samples of the goods to be imported. Secondly, the Customs classification of import and export items often appear to be arbitrary and contrary to trade ideas and practices. There have been persistent complaints received by the Chamber in this regard about mixed Woollen Fabrics, Fents, Rubber Sheetings, Waterproof Canvas, Paper items, etc.

In respect of settlement of disputes difficulties often arise in respect of short landed goods and there are too much complexities in settlement of such disputes. Then again, the time limit for filing claims proves sometimes too short for collecting all the documents which the Customs require in cases of appeals. Too much delays are also reported in disposal of claims. It has been brought to the notice of the Chamber that there is a tendency among the Customs authorities to avoid claims in various ways.

Under the present law, the penalties often cause too much hardship on the importers. For example, if an importation is considered to be unauthorised for the time being, then the goods are confiscated but it is not usually taken into due consideration that sometimes such importations become technically unauthorised due to the complexities of the Import Trade Control regulations. Secondly, if such goods are confiscated the goods are offered to the importer at an enhanced price as the cost of the goods. Such penalties should not be considered as penalties and the Customs should clearly declare these as sale-price of the goods so that it may be allowed by the Income-tax authorities as the purchase price of the goods. If such goods are auctioned by the Customs Authorities, and if any buyer other than the importer purchases it, then these are accepted by the Income-tax Authorities as the purchase price of the goods. This anomaly should be changed.

There should be an Appellate Tribunal for Sea Customs disputes on the lines of the Income-tax Tribunals.

EXPORT DUTIES.

Question 113.—Circumstances for Export Duties.

In recent years, export duties appear to have been much relied on as a source of revenue. In the opinion of the Chamber, export duties can be imposed only under the following exceptional circumstances and should never be relied upon as a source of revenue:

(a) If the country has an absolute monopoly in respect of any item and such duty does not lead to retaliatory action in the buying countries on which India may depend for import of her requirements.

(b) Special emergencies like war; or the duties may be imposed for temporary periods on revenue considerations if due to any currency depreciation there may be some temporary 'excess gain' secured by a limited number of exporters in the country.

Under the normal conditions and particularly in respect of commodities which have to face foreign competition in the international markets, the Government should withdraw from the field of export duty. Under the present circumstances when India has programmed to diversify her exports by increasing the export of manufactured articles and when the country hardly holds any monopoly in respect of any item, the present circumstances are unsuitable for continuing export duty on any item. The emergence of a buyers' market in international trade would justify the abolition of export duties. Such abolition is particularly required in respect of Vegetable Oils and Products, and Cloth. The duty on Jute manufactures should be further lowered to rehabilitate

the position of the Indian Jute goods in the world market. In the opinion of the Chamber small rates of Export cess on some products may be levied for securing funds to be spent specifically for promotion of markets for particular products.

Question 114.—Flexibility in Rates of Duty.

In the opinion of the Chamber, it would be virtually impossible to bring about the desired measure of flexibility in the rates of duty to adjust with the changing conditions of the export market. The experiences during the last four years in respect of export duties on jute goods, cotton cloth, oils etc., have definitely proved that it would not be possible to sufficiently adjust the export duties with the changing conditions. There would remain inherent administrative difficulties in making such adjustments at proper time and in adequate measures. These were pointed out by the Chamber in the preliminary Memorandum and in the course of replies to Part I of the Questionnaire. The Chamber therefore would reiterate that the Government should withdraw from the field of Export Duty.

Question 115.—Funding of Export Duties.

The Chamber is opposed to the imposition of export duties except under abnormal circumstances. Even under such emergency circumstances if export duties are levied, then a portion should be funded, for use at a time when export subsidies or bounties may be necessary, or for financing schemes for promotion of the export trade. By way of illustration, the Chamber would mention that if the Government considered it justified to draw out a substantial portion of the profit made by the exporters during recent years, due to international factors and due to devaluation of the Indian Rupee, a portion of such export duties ought to have been kept funded for assisting the export trade of the country now, when the articles are facing serious competition in the foreign market due to rigidities in the cost-price structures in India and lower international prices.

Question 116.—State Trading for Revenue Purposes.

The issues involved in the State Trading in the field of foreign trade were examined by the State Trading Committee of 1949-50. That Committee, made certain recommendations only in respect of a few of the commodities and considered foreign trade as too risky a job for the Government to undertake under the present conditions in India. The Chamber is definitely opposed to the very principle of State Trading, and it feels convinced that except under abnormal circumstances, any effort for State Trading would mean loss of revenue rather than increasing revenue.

Questions 117-123.—Central Excise Duties.

As was observed in the Preliminary Memorandum of the Chamber it appears that with the lowering adjustments in the income-tax, import and excise duties are likely to continue to play a still more prominent part in the Central Revenues. The Chamber also feels that there may be some scope for expanding the orbit of excise duties, though re-adjustments in some of the existing ones are considered necessary. The impact of excise duties is upon the industries or the trade, although their ultimate incidence may be considered to be on the consumer in the long run. While expanding the orbit of excise duty, on revenue considerations, this aspect requires to be kept in view in the selection of the items as also in the determination of the rates. The impact of Sales-tax in the different States needs also be considered in determining the coverage and level of excise duties in order that the total burden of these commodity taxes may not unduly restrict consumption.

In respect of the selection of the commodities, the Indian Fiscal Commission of 1921-22 mentioned a number of considerations, viz., that—

(1) "excise duties should generally be confined to industries which are concentrated in large factories or small areas, (2) they may properly be imposed for the purpose of checking consumption of injurious articles and especially on luxuries coming under this category, (3) otherwise, they should be imposed for revenue purposes only, (4) while permissible on commodities of general consumption, they should not press too heavily on the poorer classes, (5) when an industry requires protection, any further necessary taxation on its products may, if the other conditions are fulfilled, take the form of an excise duty plus an additional import duty. The latter should fully counterbalance the former and may be pitched at a higher rate".

The Chamber generally agrees with these considerations in selecting the commodities for imposition of Central Excise Duties. It would, however, like to add that the industries which may be developed under protection may be specially selected for levy of excise duty when such protection is no longer necessary but import duties on competitive goods are continued on revenue considerations. The level of excise duties in such cases

should be a little lower than the import duty to compensate for consumer prejudice.

The Chamber would also like to observe that under the existing conditions in the country, there would be no way out than to impose excise duties on as many consumption commodities as may be possible without much distinction being made between the so-called luxuries, semi-luxuries, conventional necessities or essential necessities. The convenience of collection and yield would, of course, have to be taken into consideration.

The method of collection should be made as simple as possible and the articles which are used wholly as industrial materials should be generally exempted from excise duties and the duty on others should be refundable when used by an industry on the finished products of which there may be excise duty.

While imposing any excise duty on protected industry, the required adjustments in import duty should also take into consideration the consumers' prejudice against indigenous products.

Subject to these general observations, the Chamber would like to indicate their views on the questions raised in the Questionnaire.

Question 117.—Selection of Commodities.

Among the Central excise duties, the collection from Tobacco and Cotton cloth have been contributing the major share during recent year. In 1951-52, out of a total of excise duties of Rs. 85.78 crores, Tobacco and Cotton cloth contributed Rs. 51.9 crores. In the Revised Estimates for 1952-53, Rs. 46 crores would be contributed by these two items in a total Central excise of Rs. 80 crores in the Budget. For 1953-54, as much as Rs. 56 crores is proposed to be realised from these two heads out of a total provision for Rs. 94 crores as Central excise. Among the excise duties now levied, the incidence of those on Kerosene, Matches, Tobacco (partially), Tea, Cotton cloth and Sugar may be considered to be partially borne by the common people also, who are outside the orbit of direct taxation.

As already mentioned, the Chamber feels that when items like Matches, Kerosene, Cloth or Sugar are subjected to excise duty, Salt and some other necessities of life can also be subjected to excise duty. The Chamber also would like to mention that the Commission may examine whether raw Tobacco and manufactured Tobacco should be both subjected to excise duty. Similarly, it may be examined whether hydrogenated Vegetable products and the Vegetable oils consumed by the Vanaspathi Industry should both be subjected to the excise duty. The idea of the Chamber is that the same commodity should not be subjected to two or more excise duties, once on raw materials and again on the finished products. This may be avoided if refunds are granted when the raw material subjected to excise duty are consumed by an industry, the finished products from which are also subjected to the excise duties.

Question 118.—Rates of Excise Duties.

(i) It has been complained that the burden of excise duties on mill-made Cotton cloth has been proving too heavy for the industry and the trade to bear, and it has been found difficult to shift the incidence on the consumer under the prevailing conditions in the market. Secondly, the cumulative effect of the import duty on Raw Cotton and Sales-tax and excise duty on cloth, appears to be restricting the consumption of Cotton cloth within the country.

Particular complaints have been made against the rates for fine and super-fine cloth. It has been also complained that mill-made Cotton cloth has been subjected to two excise duties, viz., general excise duty plus the additional excise duty for aiding the Handloom Industry, the Dhories being subjected to yet another excise duty at a graduated scale if the production of the mill exceeds the permissible quota of 60 per cent. over the 1951-52 production.

Complaints have also been made against excise duties on Motor Spirit, which has been stated to be largely contributing to the high price of this essential fuel, the material being subjected to special Sales-tax in the different States. The rate of Sales-tax on Motor Spirit is 6 as. per gallon in West Bengal in addition to the Central Excise duty of 15 as. per gallon.

(ii) Ad Valorem Rates :

At present excise duties on most of the items are at specific rates with an admixture of *ad valorem* basis in respect of Matches and Tobacco. The rates of excise duties on cloth were originally on *ad valorem* basis of fine and super-fine and on specific basis on medium and coarse qualities. Subsequently, the basis was changed, and the excise duty on fine cloth, for example, was ranged from 7 pies to 11 pies per yard on Grey and Bleached varieties and from 9 pies to 12 pies on Dyed and Printed varieties, with the option to the mills to pay the duty at the rate of 5 per cent. *ad valorem*. From the beginning

of 1953-54, this alternative basis was changed to specific, fixing the rate at 39 pies per yard on super-fine quality (recently scaled down to 24 pies), 15 pies per yard on fine, the rate on medium and coarse being continued as before. This change in the basis has increased the repressive character of the duty on different varieties of fine cloth, the present specific rate along with a uniform additional rate of 3 pies per yard, works out to *ad valorem* rates varying from a little below 10 per cent. on some varieties of fine cloth to even 30 per cent. on others. The application of specific rates on mill-made cloth which considerably varies from mill to mill, even in respect of the same variety and the same broad group quality, seems to be unsuitable, especially when the rate is considerably high.

The Chamber is not aware of any specific complaint regarding the valuation where *ad valorem* rates are levied.

Question 119.—Excise on Tobacco.

The Chamber would not make any comment on this question, excepting that complaints have been heard from small manufacturers manufacturing Cigars that rates of excise duty on Raw Tobacco coupled with the duty on manufactured Cigars, has been proving burdensome for them. It has also been complained that the preferential lower import tariff on Burmese Cigars is putting these manufacturers under a comparative disadvantage because of this high excise duty.

Question 120.—Excise on Match Industry.

No Comments.

Question 121.—Procedural Matters Re : Assessment and Collection of Excise Duties.

No Comments.

Question 122.—Earmarking of a part of Excise Duties for Expenditure on Research and Development etc.

Generally speaking, the excise duties generally levied on revenue considerations on commodities of general consumption should go to strengthen the general revenues, particularly when many development projects are being financed out of the current revenues of the Central Government. At present, however, there are special excise duties (or Cesses) levied on items like Copra, Oils extracted from Oil seeds crushed in any Mill, Coal, etc., under special Acts and for specific purposes. The Chamber would generally prefer consolidation of excise duties on industry, and in that case portions of such consolidated duty may be earmarked for specific purposes like research and development, improvement of quality and marketability of the products.

The Chamber would, however, like to emphasise that it is strongly opposed to the principle of levying excise duty on one industry and its earmarking for the benefit of another industry, such as the imposition of additional excise duty on mill-made cloth for the benefit of the Handloom Industry or the application of Cess on Oil Mills for the benefit of the 'Ghani' Oil industry.

In case of any earmarking of a part of any excess duty, the earmarking can be made only for the benefit of the particular industry subjected to the duty. The "Benefits Received Principle" should be strictly followed in this type of taxation.

Question 123.—Imposition of Excise Duties *vis-à-vis* Development of Industries and Exports.

As already pointed out in the previous questions, high rates of excise duties on Cloth, Hydrogenated Oils, Motor Spirit, etc., are stated to have affected the particular industries, and also other industries depending upon Motor Spirit. In case of Hydrogenated Oil, provision was made in 1948 for exempting it from the duty if these are used for industrial purposes. If such schemes are extended by arranging the refunds of excise duty in all cases where the products are consumed in another industry, then the restrictive effect on the consuming industries may be avoided. In the case of Cloth, the duty is stated to be restricting consumption.

So far as export is concerned, there is already provision under the Central Excise and Salt Act for refund of excise duty in case the excisable products are exported, if the Government so desired. The Chamber has, however, received complaints that rules regarding refunds are complex and the refunds cannot be obtained easily. It becomes particularly difficult to obtain the refunds in the case when the goods are exported by the merchants out of the market stocks. In effect, therefore, exports get impeded by the burden of excise duty. An effective arrangements should be made for speedy refund of excise duty, almost on a routine basis, whenever the goods are exported out of the country. Such refunds may be made to the exporter on production of export documents.

Question 124.—Re-imposition of Salt Duty.

The question of re-imposition of Salt duty is bristled with many considerations other than economic. The

Chamber is conscious of the political aspect of this duty, but it feels that in the changed circumstances of the country and when the Governments are undertaking many welfare services, the re-introduction of the Duty should be considered justifiable. It is needless to re-iterate that the duty conforms to the time-honoured canons of taxation and its incidence would be very small on the individual consumer. The previous Taxation Enquiry Committee estimated the *per capita* burden of Salt Duty at 3 pice on the basis of an average consumption of half a seer of Salt per month. In 1946-47 the rate of the duty was Rs. 1-9 per maund and the yield of the duty was roughly a little over Rs. 9 crores. The majority of the prevailing import and excise duties do not touch the rural population and the income groups outside the orbit of income-tax. A small rate of excise duty on Salt may give substantial revenue to the Government and through this duty, the entire population may be made to contribute to the development of the country. The burden on any individual would be small.

If the Government feel that the public psychology may still be affected, then the receipts from the duty may be kept earmarked for some specifically approved social services.

In this connection the Chamber would recommend that if excise duty is re-imposed on Salt, the recent levy of as. 2 and as. 3-6 per standard maund in cases of removal of Salt from the licensed Salt Factories or from the Central Government Factories, should be abolished. Secondly, the Salt consumed for industrial purposes, should be exempted from the duty as in the case of several specifications and items of Motor Spirit and Hydrogenated Oils, etc.

SALES TAX.

Questions 125-134.

All these questions appear to have been framed on the fundamental assumption of continuing the Sales-tax, and with as much adjustments as may be possible to diminish its restrictive effects on industry and trade, and to make it as much equitable as may be considered practicable. Before proceeding to indicate the views of the Chamber regarding the specific issues raised in these questions, the Chamber would like to request the Commission to carefully examine the desirability of replacing the Sales-tax by a Purchase tax.

The Sales-tax in India was introduced under the Government of India Act of 1935 and was made a provincial subject. From the beginning it was intended to be a tax essentially on consumption. The impact has been on the industry and trade. The liability of payment of tax has been on the seller and the buyer has no legal obligation to pay the tax. The Sales-tax has therefore been a tax on the margin of the manufacturer or the dealer though there has been a natural process of shifting the incidence to the consumer whenever and wherever possible. The Purchase tax on the other hand, would be a direct tax on the buyer, though the legal obligation of the seller may be continued in the matter of collection and payment to the Government. In a scheme of Purchase tax many of the prevailing difficulties in respect of inter-State trade would not be there. There would be no Constitutional amendment necessary as the States are authorised under the Constitution to tax either purchase or sale of goods. The explanation given to Article 286(1) of the Constitution empowering only the consuming State to levy Sales-tax also seems to presume that the burden of the tax is being borne by the buyer and therefore the Exchequer of his State should get the benefit of the tax. The Chamber would therefore request the Commission to examine the possibility of this change. As the Commission must be aware, in several other countries Purchase tax has replaced the Sales-tax.

With the widening of the States' functions, leading to pressing revenue needs and inelasticity of the older sources of revenue, the States in India have been looking more and more to Sales-tax as the most flexible source of revenue. The State Governments seem to be almost intolerant of any suggestion regarding Sales-tax, presumably due to the apprehension that such suggestions may result in any decline in revenue from this source. This apprehension is understandable from the fact that while the revenue from Sales-tax contributed 11 per cent. of the revenues of the Part A & B States in 1947-48, it rose to 22.5 per cent. in 1950-51. There was a little drop during 1951-52 and subsequent years, due to the constitutional prohibition on collection of Sales-tax on inter-State commerce which was being collected by almost all the States except West Bengal upto 31st March 1951. To cope with the situation, the several State Governments have been trying to increase the yield by changing the basis of Sales-tax, introduction of differential taxation and modification of the list of exempted articles and by various other means. The laws have been thus made more and more complicated, increasing the restrictive and discriminatory effects of Sales-tax on the industry and trade and adding to the burden of the business activities on account of the increase in operational costs.

At the other end, the impact of the tax has been becoming more onerous on the industry and trade with the increasing difficulty in shifting the incidence to the buyer. During the abnormal conditions of the war, and the post-war inflationary markets with high prices and profits, and larger purchasing power with the common man, the undesirable effects of Sales-Tax on prices and industry, were not so glaring as have been during recent times. For example, when the prices were very high and the margin of trade was ten, twenty or even twenty-five per cent., the relative impact of Sales-tax at 9 pies in the rupee or 4.68 per cent. was less than it is now when the trade margin has come down to two, three or four per cent. and there is consumer resistance in the matter of prices.

While the ultimate incidence of Sales-tax may be considered to be on the consumer in the ultimate analysis, and on a long-term view, the deleterious effect of the tax on industry and trade is much more pronounced than on purchasing power or consumption.

The difficulties regarding Sales-tax arise in respect of: (a) *Widely differing burdens of the tax in different States.*—The per capita tax at Saurashtra works out to as. 8 per year and it is Rs. 2-4 for West Bengal, Rs. 12-12 for Madras, and Rs. 3-4 in Bombay. In U. P. the annual per capita tax is a little more than as. 12 and is equal to that in Assam. The people in West Bengal have to bear a burden of Sales-tax of Rs. 2-4 per head per year whereas their neighbours in Assam pay as. 12 and those in Bihar as. 13 and in Orissa a little over as. 8. Though such per capita division of Sales-tax is not very accurate to indicate the burden of the tax, yet the relative position in the different States may be indicated by this means.

(b) *Different basis of Taxation.*—In the majority of the States, the tax is collected at one point whereas in States like Madras, Travancore-Cochin, Mysore and lately Bombay, the tax is collected at every point of sale. There is again combination of both single-point and multiple-point taxing in several States like U.P.

(c) *Difference in Rates.*—The rates vary from 6 pies in the rupee to 2 annas in the rupee even among the States which levy Sales-tax on a single-point basis. There is again uniform rate of tax as in West Bengal and Delhi, and differential rates on different commodities in most of the States.

(d) *Deflection of Trade.*—Sales-tax in West Bengal is at the rate of 9 pies in the rupee and it works out to roughly 4.68 per cent. The transport cost from Bombay to Calcutta for many of the articles like Motor parts, etc. do not exceed 2 per cent. Thus, for a Transport Company requiring these parts for consumption in West Bengal, finds it cheaper to bring the goods from Bombay rather than buy these from the local market and West Bengal has not attempted as yet to realise the tax from the extra-territorial selling dealer in Bombay.

(e) *Pre-Constitution realisation of Sales-tax* by most of the State Governments from despatch of goods outside the State and the post-Constitution efforts to realise sales-tax by several State Governments from dealers or consumers in other States.

(f) *Ineffectiveness of Article 286 of the Constitution* in freeing the inter-State trade transactions and exports and imports, and taxation of commodities which have been declared by the Parliament as articles essential to the life of the community, from the octopus of the divergent and complicated Sales-tax laws of different States.

(g) *Complications of the laws and rules.*—In eagerness to increase the yield of Sales-tax, higher rates, sometimes on differential basis, have been brought in and thereafter various sorts of adjustments are intended to be made. The result has been that complicated rules and procedures have been introduced and the cost of compliance has been increased, particularly for the ordinary dealers.

The restrictive effect of the present scheme of Sales-tax in West Bengal, may be said to arise from:

1. Scope of evasion due to the continuance of the system of registration (and, therefore, point of collection) on turnover basis rather than on the 'category of business' basis and the scope of imports by Unregistered Dealers.

2. Uniform rate of tax on all types of articles at the high rate of 9 pies in the rupee.

3. Taxation of a number of raw materials and other articles which have been declared recently by Parliament as articles essential to the life of the Community.

4. Complicated and long procedure in assessment of tax and examination of books, hearing of appeals, etc.

5. Lack of proper understanding and co-operation between the Taxing Authorities and the taxable Dealers.

The *bona fide* trade has been complaining for some time past that due to the evasion of the tax, the honest

dealers have been experiencing serious comparative disadvantages.

As to the directions for modifications, (if Sales-tax is continued as such), the Chamber would urge for—

(a) Centralisation of Sales-tax by amendment of the Constitution, the yield being allocated among the States on agreed basis;

(b) If complete centralisation is not possible, all inter-State transactions should at least be taken out of the purview of the State Legislations, these being subjected to Sales-tax by the Centre or Purchase tax should replace Sales-tax at least regarding such transactions. There should be no extra-territorial jurisdiction of any State to realise tax from dealers in other States. The jurisdiction of a State to levy tax should be limited to those who deal in the State and not with the State;

(c) Standardisation of Sales-tax coverage and rates in the different States, on a model plan, if the levy of Sales-tax with the State continues to remain as State subject;

(d) Standardisation of the Schedule of exempted articles in terms of the Essential Goods Act and modification of the list in order to include all industrial raw materials and those goods on which the Centre levies high rates of excise duties;

(e) Introduction of a single-point sales-tax system in all the States;

(f) Securing effective exemption from Sales-tax of transactions in the course of export-import trade of India.

In the light of these, the views of the Chamber in respect of the specific questions raised in the Questionnaire are indicated as under:

Question 125.—Sales-tax on Services and Stock Exchange Transactions etc.

(i) Imposition of Sales-tax on services would be virtually taxation of income and the Chamber is opposed to the extension of sales-tax on such services enumerated in the first part of the Question, like Goldsmith's services, Painter's services, Photographer's services, etc. The sales-tax should be only in respect of the goods transferred and not on the charges made in respect of services rendered. In West Bengal, tailoring charges or printing charges, etc. are not subjected to tax if the cloth or the paper is supplied by the customer and the tailor or the painter maintains separate accounts for such cases as distinct from those where the cloth or the paper may be supplied respectively by the tailor or painter himself. In the opinion of the Chamber, in these latter cases also, a portion of the total turnover should be exempted from Sales-tax to ensure that the services do not get taxed.

(ii) The transactions in the Stock Exchanges and the Futures Market should not be considered as transfer of goods and therefore should not be subjected to sales or purchase tax. Moreover, such transactions already bear heavy stamp duty and registration fees.

Question 126.—Sales-tax on Advertisement in Newspapers.

As was pointed out in reply to Q. 34 (f) in Part I of the Questionnaire, the Chamber is opposed to taxation of the sale or purchase of newspapers and any tax on advertisement. The sales-tax on advertisement would add to the business costs and the burden of other taxes and fees is already very high on business activities. Moreover, various Municipalities are already subjecting advertisements under different imposts. The Corporation of Calcutta has framed rules for realising fees for issue of licenses both to advertisers and other Agencies undertaking advertisement on behalf of others. This would be virtually an advertisement tax, in addition to the trade license fees that are collected by the Corporation. The Committee also agrees with the reasons indicated in the question itself regarding Sales-tax or newspapers.

Question 127.—Sales-tax vis-à-vis Excise, Octroi and Customs.

The Chamber does not consider it feasible to merge Sales-tax, Excise duties, Octroi and Customs as raised in the Question. Separation of Sales-tax from the other commodity taxes has been necessary as a measure of adjustment in the Federal Finance of the country which cannot be upset. Sales-tax is a State subject, while the principal excise duties and terminal taxes are Central subjects. The Octroi duties are in practice used only by local Bodies. Moreover, Sales-tax becomes payable only when the sale is effected whereas, all the other levies are made either on production or on the entry of the goods into the respective areas. This difference is of considerable importance to the industry and trade.

The Chamber would, however, like to stress that some sort of co-ordination is required between Sales-tax, Excise duty, and Import duty so that the cumulative burden of all these imposts on the same commodity may not prove to be too burdensome and restrictive of consumption. The Chamber is opposed to terminal

tax and Octroi duty, and the goods already subjected to Excise or Import duty and State Sales-tax should at least be specifically excluded from the orbit of Terminal tax or Octroi.

Question 128.—Computation of Sales-tax on aggregate Turnover Basis and a Sales-tax on Federal Basis.

The Chamber agrees with the view that Sales-tax should be levied in terms of the aggregate turnover of the dealer during given periods, rather than on individual transactions. At present, however, the assessing Officers do check individual transactions at the time of assessments and for which the dealers have to keep themselves prepared for such check up. The present Scheme of turnover basis of assessment, should therefore be made categorical so that the smaller dealers who do not find it possible to maintain Cash Memos and other records for individual transactions, may not have to face difficulty on this count. Generally speaking, the present system of turnover assessment should continue.

(b) On principle, the Chamber is not in favour of imposing sales-tax on different commodities by different specific laws. Such a method makes it difficult for a dealer to have composite business. There is hardly any commodity which is dealt with at present on exclusive basis. Petrol is at present taxed in West Bengal at a specific rate whereas the general Sales-tax is on *ad valorem* basis. This is possible because of the special procedure through which the article is sold.

Question 129.—Multiple Point versus Single-Point Tax.

(1) The Chamber is in favour of the single-point tax system on the West Bengal pattern, but with the following adjustments, so that the basic assumption of the West Bengal Scheme that every article must pass through at least one registered dealer before it reaches the consumers, may be effectively secured:

(a) All Importers of taxable goods into a State should be required to get registered without any turnover limit. At present imports into West Bengal upto Rs. 10,000 a year from other States is permitted through Unregistered Dealers. This provides a loophole and large stocks of goods enter into the State by unregistered importers and such goods remain wholly outside the orbit of taxation within the State and this puts the registered dealers in the State at a comparative disadvantage.

(b) All manufacturers in a State falling within the purview of the Factories Act should be registered without any turnover limit, and for this the existing limit of Rs. 10,000 for registration of manufacturers in West Bengal should be abolished. All new factories should be required to get registered within one month from the date of registration.

(c) Such co-ordination should be established between the Sales-tax authorities and the Carrier organisations as would make it impossible for any importer to bring any goods into the State without the knowledge of the taxing authorities.

(d) Registration of Dealers should be made on a stricter basis to guard against *mala fide* registrations secured for trafficking in Sales Tax Certificates. Registration should be provisional in the first instance requiring submission of monthly returns and on submission of such returns for 12 months and after other check-ups regarding *bona fide*, permanent Certificates should be issued.

On the question of whether the realisation of the Sales-tax should be at the first point of sale (popularly termed as "Collection at Source" System) from the importer or the manufacturer, or whether it should be at the last point of sale from a registered dealer to an unregistered dealer or, a consumer, has proved to be controversial among the merchants. If compulsory registration of all importers and manufacturers without any turnover limit is introduced in the West Bengal scheme and if other modifications as suggested above are made, then the present scheme of "last point" collection should be continued. If however, the *mala fide* registration and avoidance by non-registration cannot be effectively checked then the collection of Sales-tax on single-point basis should be at the first point of sale. In the latter scheme, the indigenous manufacturers within the State who may not come within the purview of the Factories Act would go unregistered and it may be difficult to tax the products of such manufacturers. The volume of such transactions, however, are not likely to be very large. Secondly, the 'dealers' other than the registered manufacturers and importers would be at comparative disadvantage relative to such registered dealers, in so far as their purchases intended for sale to other States would get taxed. Refunds in such cases may be too difficult in practice. The collection at the first of sale may be simpler and easier.

In the opinion of the Chamber, the yield of the Sales-tax in West Bengal would increase if the modifications

suggested by the Chamber are accepted. The yield from multiple-point taxation may be larger but regressive character of the tax and its restrictive effect on industry and trade are much greater under multiple-point system. The cost of collection is also likely to be higher under multiple point system. If on the other hand, the bad aspects of multiple-point system are attempted to be minimised as in the recent Bombay Scheme, then the whole pattern becomes very much complicated adding both to the cost of administration and of compliance.

(2) The comparative merits of multiple point and single-point tax systems have been discussed for long in the country and it is presumed that the Federation of Indian Chambers of Commerce and Industry would be placing all the facts on the experiences of the Sales-tax Acts in the different States which have practised either of these two systems and their combinations, for several years past.

(3) The Chamber would, however, like to just mention in brief their views on the specific points raised in the third part of the Question.

(i) Sales-tax *vis-à-vis* Consumer :

In West Bengal, the single-point tax system has operated since its introduction in 1941. It is, however, felt that there has been considerable evasion by non-registration and registration in mofussil areas seems to have been very low. The imports through unregistered dealers are also reported to be considerable. All these have resulted in a lower yield from the tax compared to the high uniform rate of 9 pies in the rupee. The collection of the tax in West Bengal was Rs. 4.3 crores in 1948-49, Rs. 4.6 crores in 1949-50, and Rs. 4.8 crores in 1950-51, (Revised Budget Estimates) and Rs. 5.6 crores in 1951-52. The Chamber has considered this yield to be rather low compared to the existing high uniform rate.

But this is not due to the system as such. From the latest available administrative Report of the Director of Commercial Taxes (1949-50), it appears that there were only 15,036 firms throughout West Bengal under compulsory registration and 9,436 firms under voluntary registration. Of the total of 24,472 firms only 7,069 were in the Districts and 17,403 in Calcutta. It may be noted here that the present limits for registration are on the basis of turnover and these limits work out to sales of Rs. 833.1/3rd per month for voluntary registration of dealers and for compulsory registration of manufacturers and importers. The compulsory registration limit for dealers also works out to a sale of Rs. 4166.2/3rd per month. These definitely indicate that there has been avoidance by non-registration which must necessarily result in putting a greater burden on the consumer than may be accounted for by the proceeds which accrue to the West Bengal Exchequer.

The Chamber does not consider that the consumer has to pay more under the single-point system than accrues to the Exchequer. The dealer's realisation on small sales is usually fractions of the standard rate and is counterbalanced by non-realizations.

Under the multiple-point system the position of the consumers is worse because the actual burden on a consumer would depend on the number of stages through which the commodity may be passing in order to reach him. Though the rate may be the same, the consumers of different commodities have to bear different incidence of the tax. The scope of evasion is not necessarily minimised under the multiple-point system.

(ii) Sales-tax *vis-à-vis* the Dealer :

The registered dealers in West Bengal are at a comparative disadvantage with the unregistered dealers who sell to the same stream of consumers because of the considerable scale of avoidance of registration and *malafide* registration. Under the single-point system the necessary adjustment in favour of small dealers can be more easily made and the tax has no discriminatory effect against the traders as compared to manufacturers or against the traders at later stages of the flow of goods. Under a multiple-point system there is bound to be a tendency to short-circuiting the goods, resulting in the elimination of a large number of traders, and this would affect employment in the country. Under a multiple-point system inter-State trade and export trade would also get taxed, which can be avoided under single-point system, if the traders having such dealings get themselves registered. By way of illustration, the Cloth merchants in West Bengal generally purchase goods from Commission Agents and thus most of the Cloth coming from Bombay and Ahmedabad has to bear Bombay Sales-tax in practice though Bombay cannot and does not directly levy the tax on exports out of the State.

Regarding the simplification of rules and procedure, the Chamber would suggest the following with reference

to the single-point tax system prevailing in West Bengal :

(i) The names of the Registered Dealers should be published in alphabetical order and Charge-wise. Additions and cancellations should be similarly published and circulated among the recognised Chambers of Commerce within 7 days from the date of each registration and cancellation. At present there is a serious lapse in all these respects and there has not been any marked improvement in these directions in spite of representations.

(ii) There should be a special Department under the Commissioner of Commercial Taxes only for dealing with the files of untraceable firms.

(The Chamber made some suggestions in this line to the West Bengal Government in July last. The work was assigned to Police Department and the Chamber does not consider that the Police Department can secure any effective improvement in these directions).

(iii) The assessment of taxes should be more promptly completed and the assessment procedures should be less complicated and harassing.

(iv) There should be a Public Relations Officer at the Commercial Taxes Directorate for offering correct guidance to Registered Dealers, and thus for creating a feeling of co-operation between the Trade and the Taxing Authorities.

(v) There should be an Advisory Board consisting of the Representatives of the Trade and the Consumers to advise about better administration of the Sales Tax Law and Rules.

As already mentioned, the registration of the dealers should be also made with greater caution.

So far as the forms are concerned, the dealers have not much complaint in West Bengal.

The rules are however complicated and this has increased the cost of compliance in various ways.

In order to make a fresh start, some immunity period should be given for registration without calling upon the dealers to produce books and records for the past, and all pending cases should be composed within such an immunity period if voluntary returns are submitted within such immunity period, as was done in respect of income-tax.

(iii) Sales-tax *vis-à-vis* Industry and Trade :

As have been observed in the preliminary observations above, the divergence of Sales-tax in the different States have affected the organisation of industries and trades in the country. The industries in the States with multiple-point sales-tax have to bear differential burden of the tax than in the States with single-point sales-tax and this differentiation affects the location of industries. The multiple-point sales-tax has a tendency to eliminate intermediaries. The Schedule of exempted goods is bound to be shorter under multiple-point system than under single-point system. Yet another example of the deleterious effect of the multiple-point Sales-tax in Bombay has been recently provided by the piling up of cloth stocks there with the Mills. Had the tax been single-point, the trade would have purchased the stocks for sale outside the State, for exports etc. without incurring tax liability. Thus, the financial burden of holding stocks might have been borne by the Mills and the Trade, as has been the practice of the business.

(iv) Sales-tax *vis-à-vis* Government :

It has been already pointed out, that administration of single-point tax system is bound to be simpler than a multiple-point tax system, and the difficulties arising out of evasion may be better met under a single-point tax system if the suggestion regarding registration etc. as indicated above are accepted.

Question 130.—Differential Taxation.

Excepting West Bengal and Delhi where the West Bengal system of Sales-tax has been introduced with some modifications, differential rates are being applied for different articles in almost all the States of India. On principle, the Chamber is not in favour of different rates of tax levied on different commodities. It would urge for a uniform exemption list of commodities whereupon no sales-tax would be charged in any State. If such an exemption list is introduced there would be no necessity of differential taxation of different articles.

The Committee would, however, like to stress that if the rate is to be kept uniform it cannot be as high as 9 pies in the rupee or 4.68 per cent. as exists in

West Bengal. The maximum rate should be 6 pies in the rupee with a fairly wide Schedule of exempted goods.

In view of the observations made above, the Chamber would not favour any special rate or levy higher than the ordinary rate for certain articles nor would it favour the special rate of levy lower than the ordinary rate for certain articles.

If however, a high rate of Sales-tax is perforce continued or levied, even at the level of the present West Bengal rate, then the Chamber would suggest the preparation on an all-India basis of a list of commodities on which the rate of the tax shall not exceed 6 pies in the rupee in any State.

Regarding the principles to decide the Schedule of exempted commodities, the Chamber would suggest that the goods declared to be essential for the life of the community by the Essential Goods Act of the Parliament, should be all exempt from the Sales-tax in every State.

Secondly, essential consumption goods, medicines, and clothing for the common man (*i.e.*, up to certain price limits) should be exempt from Sales-tax. In West Bengal items like fruits or firewood are also taxed. The result is that the urban population have to bear the burden of the tax on these items whereas these cannot be collected in the rural areas. Such items should be exempted from Sales-tax. Lastly, the items on which there may be heavy excise duty of the Centre should be either exempted from Sales-tax or should be lightly taxed.

Question 131.—Uniformity in Sales-tax System.

The lines of uniformity have been indicated in the preliminary observations made in respect of sales-tax in general. There should be uniformity in respect of the basis of tax, point of registration and collection, exemption list, and rates of tax on similar commodities etc. As to the courses for securing uniformity, as mentioned in the Question, the Chamber would like to indicate their views as under :

(i) It is true that uniformity may be secured by formal or informal convention, but as far as the reports go regarding the last Finance Ministers' Conference and subsequent discussions there seems to be not much possibility of securing the uniformity by formal or informal convention. If the States can arrive at agreed and suitable decisions and if they agree to abide by a Convention, then there would be also no objection in securing the needed constitutional amendments.

(ii) Constitutional amendment promoted at the instance of two or more States is not likely to be binding on the other States and therefore the difficulty would continue.

(iii) If all the points indicated before on which uniformity is required, can be secured by putting the subject of Sales-tax on the Concurrent List in this regard, the Chamber may agree to such a procedure. It would, however, like to stress that in any case, taxation of inter-State transactions should be entirely in the hand of the Central Government.

(iv) No comments.

Question 132.—Uniformity Secured under Clause 3 of Article 286.

The Essential Goods (Declaration & Regulation of Tax on Sale or Purchase) Act, was at last passed by the Parliament in 1952 (*i.e.*, after two and half years after the inauguration of the Constitution), in terms of the Article 286(3) of the Constitution, to secure uniformity in the matter of taxation of a number of commodities dealered to be "goods essential for the life of the Community". The legislation, however, appears to have been made nugatory in so far as desirable uniformity of taxing the essential goods is concerned. The law has been made only prospective and has permitted the continuance of the tax even on the Scheduled goods, if such taxes had been existing before this enactment. The result has been that in most of the States, a number of commodities declared to be essential by Central Legislation, still continue to be taxed. For example, in West Bengal, the following commodities which are scheduled in the Central Act as essential commodities, are subjected to Sales-tax even now :

Sugarcane, Cocoanuts, Vegetable and Flower Seeds, Edible Oils and Oilseeds from which edible oil is extracted (except Mustard oil, Rape oil or a mixture of Mustard and Rape oils), Milk products, and Eggs, Coarse and Medium Mill-made Cloth above notified prices, Handloom cloth above notified prices, Agricultural Machinery, Cotton Seeds, Jute Seeds, Sunn Hemp, Mesta, Cotton Thread, Hides and Skins, Cattle Feeds, Coal including Coke and Derivatives, Iron & Steel.

Secondly, the Central Legislation itself has not declared a number of commodities, which in the opinion of the Chamber, should have been declared as articles essential to the life of the Community. For example,

Vanaspati products, Sago, Cloth of Fine qualities, Quinine, Drugs and Medicines, Firewood, Timber, Cement, Bricks, etc., should have been included in the Schedule of articles of the Central Legislation.

In the opinion of the Chamber, the Central Legislation should have made the State laws inoperative in so far as the taxation of the Scheduled articles is concerned.

Question 133.—Taxation of 'Sales outside the State' and 'Inter-State' Commerce.

It has already been pointed out in the preliminary observations that inter-State trade has become almost impossible because of the extra-territorial jurisdiction that has been recognised for the States by the Supreme Court, in their judgement given in the case of "The State of Bombay and Another *vs.* the United Motors (India Limited) and Others". A dealer in one State who despatches goods to another State as a direct result of the sale for consumption in that second State, is liable to pay sales-tax to that second State. Various States have been calling upon the dealers in other States to get themselves registered in those States. A dealer in Calcutta thus, is being required to get himself registered under the Sales-tax laws of eight, nine or ten different States to which he may be despatching goods for the buyers there. It is needless to emphasise that it is impossible for a dealer to carry on the trade in this way. Such extra-territorial registration of dealers is unworkable for the following reasons:

(a) A seller selling to other States shall have to be conversant with the Sales-tax Acts and Rules in all other States;

(b) Such a seller may be asked to produce his books of accounts before the Sales-tax Authorities in different States;

(c) Such a seller may be called upon to appear personally in different States to which he might have sold goods;

(d) He may be called upon to maintain separate accounts of his transactions not only with dealers in the different States but also with dealers falling under the jurisdiction of the different Sales-tax Officers in these States;

(e) The enforcement of the Sales-tax laws by the different States and realisation of the tax from dealers outside the State would be impracticable for the State Governments and their efforts in these directions can only create deadlocks in inter-State trade.

The difficulties can best be met if Sales-tax is completely centralised. Alternatively, at least the inter-State transactions should be centralised for the purpose of Sales-tax. There must not be any extra-territorial jurisdiction of a State to call upon the dealers of other States to pay Sales-tax to it. A State can at best be entitled to tax for sales *within* the State and not sales effected in some other State with a dealer of the State.

It has been suggested that the Sales-tax should be substituted by Purchase tax at least in respect of inter-State dealings. The significance of this suggestion appears to be that when a dealer or a consumer buys goods from dealers in other States, such a buyer who is within the territorial jurisdiction of the consuming State should be liable to pay the tax to his State and the seller in a different State would not be liable for the tax to the consuming State. There appears to be no Constitutional bar with regard to this suggestion. On the other hand, such partial substitution of Sales-tax by Purchase tax in respect of inter-State transactions only and to the exclusion of intra-State transactions, may make the Sales-tax system in every State more complicated, particularly if some States continue to levy tax on multiple-point basis while other continue to levy the tax on a single-point basis.

The Chamber does not consider it desirable to introduce Purchase tax on some commodities and Sales-tax on others within the same State. The Chamber, would therefore, reiterate that the whole Sales-tax scheme may be replaced by a Purchase tax scheme, if complete centralisation of the Sales-tax is not possible.

Question 134.—Effect of the Lack of Uniformity in Sales-tax on Trade.

The diversionary effect of the divergent Sales-tax basis rates, and rules and procedures, has already been pointed out by the Chamber in the course of the preliminary observations to these Questions and in the course of the replies given to the third part of Question No. 129. These undesirable results can not be avoided unless the measures of uniformity as suggested in the replies to the previous questions are secured.

STATE EXCISES.

Question 135.—State Excise Duties.

The State Excise Duties have been one of the principal sources of revenue to the State Governments,

until recently in some States. So far as West Bengal is concerned, the significance of State Excise to the total revenue has increased. In 1938-39, the realisation under State Excise was Rs. 1.59 crores in a total revenue of Rs. 12.77 crores in Undivided Bengal. In 1946-47 the State Excise accounted for Rs. 6.42 crores in a total revenue of Rs. 39.9 crores. In 1951-52, the revenue from State Excise continued to remain at Rs. 6.72 crores in a total revenue of Rs. 38.59 crores in West Bengal. The Revised Budget for 1952-53 estimates the revenue from State Excise at Rs. 5.73 crores in a total revenue of Rs. 38.29 crores and the Budget Estimates for 1953-54 keeps the figure at Rs. 5.61 crores in a total revenue of Rs. 38.1 crores. In several other States, however, like Bombay and Madras, the revenue declined very steeply during the years 1950-51 and 1951-52. In Bombay, for example, the yield from the duty was brought down to Rs. 1.07 crores in 1951-52 and to Rs. 0.92 crores only in 1952-53 as compared to Rs. 9.74 crores of 1946-47 and Rs. 6.17 crores of 1949-50. In Madras also, the yield became practically nil during 1950-51 and 1951-52. Such declines have been principally due to the adoption of a vigorous Prohibition Policy in those States.

The bulk of the State Excise revenue is realised from duties on liquors and intoxicants and therefore the revenue from this head is directly linked up with the Policy of Prohibition. The Chamber certainly desires that the people in a country like India should be less and less addicted to intoxicants like liquors or ganja etc. but they would like to stress that mere legislation in this regard cannot secure the social objectives in a matter like this. While a State can relinquish its revenues by illegalising the manufacture or trade or consumption of an intoxicant, it does not necessarily follow that those addicted to such intoxicants thereby change their habits. The result becomes that while the State loses the revenue which might have been spent on welfare services and for developmental purposes, the social ills go underground and continue there. It would be interesting to assess if possible, how far the loss of revenue to the States of Bombay and Madras compares with the decrease in the actual consumption of the intoxicants there.

Secondly, the Chamber would like to stress that such prohibition policies, if followed on State basis, may ultimately result in regional inequities in the matter of allocation of financial resources. If certain States relinquish their revenue on State Excise, it would naturally either make attempt to make good the loss through other measures of taxation which may impede the industry and trade or may prove to be equally inequitable from the point of view of the people in general. The Bombay Government's efforts to increase the yield from Sales tax by introduction of multiple-point tax is a case in point. Moreover, if such loss in revenue be replenished (directly or indirectly) by diversion of the divisible pool of income-tax and Central Excise Duties, then the other States get inequitable treatment. The Chamber would therefore urge for a uniform policy in the matter of prohibition and relinquishment of revenue for that, in all the States.

The Commission may also enquire as to the reasons for which the *per capita* revenue on State Excise widely varies from State to State as will be clear from the following figures:

**PER CAPITA RECEIPT UNDER STATE EXCISE
PER YEAR. 1951-52.**

STATE.	Rs.
Pepsu	6.7
Hyderabad	5.1
West Bengal	2.7
Mysore	2.3
Travancore-Cochin	2.6
Madhya Bharat	2.2
Bihar	1.2
Orissa	1.4
Uttar Pradesh	1.0
Bombay	0.3
Madras	0.1

In the opinion of the Chamber, the better course for pursuing the Prohibition Policy would be to tax the undesirable intoxicants at high rates on a uniform basis in all the States, and other conditions about manufacture, warehousing etc. should be more or less uniform in all the States.

GENERAL.

Question 136.—Vesting the Administration with Powers to Alter Import-Export and Excise Duties.

The Chamber is not in favour of giving wide powers in the hand of the Executive Officers to alter by

executive orders the rates of import duties, export duties and excise duties. As has already been pointed out by the Chamber, it considers that it would be impossible to adjust the export duties in adequate manner even if the executive powers are there for making the adjustments. Such powers have already been there and still it has been experienced that there has remained considerable time-lag between the need for adjustment and the actual adjustment. If export duties are continued, such executive powers for adjustments of the duties would be required, but this should be exercised more promptly and at highest levels in consultation with a permanent machinery. All such alterations, however, should be brought before the subsequent Session of the Parliament for its approval.

Question 137.—Extension in the Field of Commodity Taxation.

The Chamber considers that with the progress of the Five Year Plan, the yield from the different commodity taxes are likely to increase. Moreover, by better administration also the yield from some of the commodity taxes like Sales-tax in West Bengal can probably be increased. The Chamber does not consider that there is further scope for imposing any new commodity tax.

Question 138.—Differential Taxation of "Luxury Articles".

The Chamber considers that it would be extremely difficult to single out some articles which may be considered to be 'luxury articles' for all sections of the community. It therefore does not favour differentiation in commodity taxation for different items.

PART IV.—AGRICULTURAL INCOME-TAX, LAND REVENUE AND IRRIGATION RATES.

Agricultural income-tax, land revenue and irrigation rates are all taxes on land. As such, the Chamber does not propose to give detailed replies to the Questions posed relating to these taxes and levies, except in a general way, in so far as these have bearing on the tax system as a whole.

In its preliminary Memorandum submitted to the Commission (para. 5), the Chamber emphasised the need and justification for increasing the revenues from the land taxes. It is only too patent that land revenue and agricultural income-tax contribute very small portion of the total Indian revenue.

So far as West Bengal is concerned, it may be pointed out that while the land revenue contributed 23 per cent. of the total revenue in 1925-26, 25 per cent. in 1938-39 and a little over 10 per cent. even in 1946-47, it has been contributing less than 6 per cent. of the revenues of West Bengal during recent years. No doubt, in an industrial State like West Bengal, the yield from land revenue would be less significant in the total revenue as compared to the position in less industrial States. Still, it would be found that in 1952-53, while land revenue contributed 11.7 per cent. of the total revenue in Bombay, 14.2 per cent. in Madras, 20.4 per cent. in Uttar Pradesh, the proportion in West Bengal was only some 5.7 per cent.

Secondly, the *per capita* levy on account of land revenue varies widely from State to State, ranging from Rs. 0.4 in Bihar and Rs. 0.8 in West Bengal to Rs. 3.2 in Madhya Bharat and Rs. 3.7 in Saurashtra. It appears that with the progress of agrarian reform in the country, more or less on a uniform principle, the scale of land revenue should also be brought at more reasonable levels of comparability, even though exact uniformity may not be possible.

Agricultural income-tax has been so far introduced only in some 8 States and the yield has been contributing very little to the respective revenues of the States, excepting probably Assam and Travancore-Cochin. The agricultural income-tax contributed some 1.8 per cent. of the revenues in West Bengal, 1.6 in Uttar Pradesh, 7.1 per cent. in Assam and 5.1 per cent. in Travancore-Cochin in 1952-53. The rates of agricultural income-tax varies from State to State and in West Bengal it is a progressive rate on slab system, the first slice of exempted income being Rs. 1,500 and the maximum rate being 0.4-0 in the rupee on the slab exceeding Rs. 20,000. The agricultural income up to Rs. 3,000 a year is wholly exempted from the tax. It may be mentioned here that in the income-tax law, the maximum rate is applied at a lower slab (Rs. 15,000) and the rates and the exemption limits are also different. The entire income of the agricultural Companies is taxed in West Bengal at the maximum rate of 0.4-0.

The views of the Chamber regarding the adjustments in respect of agricultural income-tax have been indicated in reply to Question Nos. 53 and 54 of Part II of the Questionnaire. If the integration suggested there is not accepted, and the agricultural income-tax is continued separately, and at State levels, then the Chamber would urge for some sort of uniformity in respect of

graduation, rates, exemption limit and application of the maximum rate. The basis of the tax in that case should also be gross income and some adjustment may be necessary either on the principle of progressive averaging or periodical adjustment.

Regarding Question No. 144, the Chamber would only like to reiterate their view that partial collection of land revenue in kind should be possible, particularly for creating local reserves and/or for financing local development through village panchayats.

Regarding Question No. 151, the Chamber may mention that so far as West Bengal is concerned, there has been some diversion of agricultural land in rural areas for non-agricultural purposes, in connection with the rehabilitation of the displaced persons from Eastern Pakistan. Some lands classed as agricultural also appears to have become part of urban areas as a result of the expansion of Municipal areas in certain cases. In such cases, adjustments in respect of land revenues may be necessary.

Regarding the issues raised in Question Nos. 155-161, the Chamber would like to state that while betterment levies may not be immediately possible, imposition of irrigation rates and small compulsory cess should be considered feasible and desirable. As equal facilities in respect of water, irrigation etc., may not be available to all the lands in a developmental area, consolidation of land revenue, irrigation rate and cess may not be desirable in the initial stages at least.

In fine, the Chamber considers that the yield from the taxes on land can be significantly increased principally by revision of the land revenue system and rates, and the scope for agricultural income-tax and other rates and cesses, are not likely to be of the same significance. The agrarian reforms undertaken in the various States are also likely to decrease the taxable capacity of the agricultural sector, so far as agricultural income-tax is concerned. But with the abolition of intermediary land interests the revenue from land should substantially increase.

PART V.—OTHER TAXES (Central and State)

STATE TAXES IN WEST BENGAL.

The question posed under this Part relate to taxation measures directly affecting the finances of the State Governments. Before replying to some of the Questions, the Chamber would like to invite the attention of the Commission to the fact that the level of internal taxation has been highest in West Bengal during recent years. Excluding the receipts from the Centre, either as grants or as shares in the divisible pools, the percentage of internal tax revenue to the total internal revenue has been 82 in West Bengal on the basis of the average figures for the years 1948-49 to 1951-52, whereas this percentage has been 76 in Madhya Pradesh, 73 in Bombay, 66 in Madras, 65 in Uttar Pradesh and Bihar, 63 in Part B States in the aggregate, 57 in Orissa and 56 in Assam. The percentage of internal tax revenue to internal revenue in West Bengal works out to roughly 74 even in the Budget for 1953-54. This would indicate the dependence of West Bengal finances on tax revenue.

The general position of finance has also been bad in West Bengal and the State has been going on with an increasing trend towards deficit Budget. The public debts has also been increasing. The public debt of West Bengal was Rs. 9.73 crores in 1948-49 and it increased to Rs. 24.39 crores in 1950-51. While most of the other principal States had accumulated Development Reserve Funds during the war and post-war years, West Bengal had no such funds on which it could lean for meeting any developmental expenditure even partially. In fact, West Bengal, the Punjab, and Orissa are the only three Part A States which have no developmental Reserve Funds. All these explain the efforts of the West Bengal Government to increase the revenue of the State by widening and intensifying the coverage and load of taxation within the State.

The Chamber would like to indicate below the trend in the principal heads of taxation in West Bengal since the enquiry made by the last Taxation Enquiry Committee :

STATE TAXES IN WEST BENGAL.

N.B.—1. Figures for years 1925-26, 1938-39 are for Undivided Bengal.

2. Figures are in Rs. lakhs.

HEADS.	1925-26	1938-39	1951-52	1953-54 (B. E.)
TOTAL REVENUE	1298.55	1276.61	3858.80	3815.9
State Excise	228.02	159.35	671.6	560.6
Agricultural Income-Tax . . . . .	..	..	64.8	65.0
Land Revenue	300.57	324.10	209.9	209.6
Entertainment Tax	5.38	7.58	109.8	110.6
Betting Tax	14.43	10.28	56.2	60.0
Motor Spirit Sales-Tax . . . . .	..	..	168.4	110.0
General Sales-Tax . . . . .	..	..	564.0	560.0
Motor Vehicles Tax . . . . .	..	21.90	81.5	107.4
Salt Tax	—	13	—	—
Electricity Duty	—	—	94.4	100.0
Stamp Duty	357.98	257.77	292.7	287.0
Registration Fees	38.92	24.12	44.8	42.5

It would be seen that while the total revenue of West Bengal in 1953-54 has been roughly three times of that of the revenue of undivided Bengal in 1938-39, the yield from land revenue has substantially decreased. Secondly, the new items of taxation like general Sales-tax, Motor Spirits Sales-tax, and Electricity duty which were altogether absent in 1938-39 have become crucially important in the State revenues. The yield from Motor Vehicles tax has increased five times as compared to 1938-39 and that from Entertainment tax more than fourteen times. The Betting tax has increased roughly six times.

Among these taxes, State Excise, the Sales-tax on Motor Spirit, and Motor Vehicles tax have been considered to have affected the industry and trade in general. The basis for levy of Entertainment tax has also been objected to. The non-tax sources of revenues of the State have not been earning any significant portion of the revenue during recent years, inspite of the State

Government's undertaking of road transport in Calcutta and Cooch Behar.

On the background of the trends indicated above, the Chamber would give reply to some of the specific questions posed in this Part.

STAMP DUTIES & COURT FEES.

Question 162.—Constitutional position and Question of Uniformity.

It has been complained that the constitutional position in respect of the levy of stamp duties and diversities among the rates in different States have been creating difficulties in cases where the instruments are executed in one State and are to be used subsequently in another State where the rate of duty may be higher than in the first State. The Chamber is of the opinion that uniformity in the rates of stamp duty would be the best solution. Failing this, at least a ceiling rate may

be decided either by Central Government or by the State Governments jointly, beyond which no State Government should levy stamp duty.

Question 163.—Stamp Duty on transactions in forward markets and on other transactions.

The Chamber is opposed to substitution of stamp duty on transactions in Stock Exchange and Futures Markets by any other tax.

The Chamber has no particular experience about the deleterious effects of levying stamp duties on transactions in Forward Markets in Bombay.

Question 164.—Collection of tax through fixation of stamps.

In West Bengal, Entertainment tax is collected in the form of stamps. This requires that the exhibitors must purchase the stamps in advance before the sale of the tickets, involving payment of tax in advance, so to say. The Chamber is opposed to any extension of this method of collection of taxes on the sale of goods. The various license fees are also collected in West Bengal in the form of non-judicial stamps. This may be continued.

Question 165.—Evasion or avoidance of payment of stamp duty.

The documents become non-enforceable if these are not adequately stamped. The Chamber therefore does not consider that there can be much of evasion of the payment of stamp duty. If the stamp duty, however, is made very high on any category of transactions, then there may be tendency to avoid the duty by entering into informal dealings without legally enforceable documents. It cannot, however, be said that such informal transactions are always made with the object of avoidance of stamp duty. Such transactions may be necessary on purely trade considerations also.

Questions 166-167.—Rates of Court Fees.

As the Court Fees are collected in connection with the administration of justice, the rates should be just to cover the expenses. Moreover, the administration of justice should be cheap and uniform throughout India. If it is found that the expenses involved in the administration of justice differ in different States then also a ceiling rate should be fixed by the Centre beyond which no State should be entitled to increase the Court Fees. It may be also considered that in case of uniformity in Court Fees, whether the States wherein the expenses may be higher should not meet the deficits out of other sources.

TAXES ON MOTOR AND OTHER VEHICLES.

Question 168.—System of Motor Vehicles Taxation.

The Motor Vehicles Taxation Enquiry Committee examined the present system of taxation of Motor Vehicles and they pointed out that the tax burden on Motor and Motor Vehicles was highest in India and that there were too many taxing authorities and multiplicity of taxes. That Committee also stressed that the basic approach that Motor Vehicles were luxury items should be revised. The Chamber generally agrees with this analysis of the Motor Vehicles Taxation Enquiry Committee. Motor Vehicles taxes should not be viewed as luxury taxation, as Motor Transport has significant bearing on industry and trade and are in a way essential public utility services. The Railway Transport facilities are not adequate and the Planning Commission also appear to be in favour of developing not only feeder road transport but also parallel road transport, to supplement railway transport. The whole system of taxation should be viewed from this angle.

Secondly, the Motor Vehicles Taxes should be principally applied on the benefits-received and cost-of-service principles. The revenue consideration should be of secondary importance.

Thirdly, though Motor Vehicles taxation may continue as a State subject, the various State laws should not be allowed to impede inter-State transport of goods on road.

In the opinion of the Chamber, the number of taxation authorities should be lowered by abolishing the local taxes on Motor Vehicles wherever existing, while the share of State taxes may be given to the local authorities who are in charge of maintaining the roads within their respective jurisdictions. At the present stage of development of road transport, too much emphasis need not be given on taxation of Motor and other Vehicles for purpose of general revenue. As has been indicated above, the Motor Vehicles tax was only Rs. 21.9 lakhs in 1938-39 and Rs. 34.7 lakhs in 1946-47 in Undivided Bengal. It was increased to Rs. 81.5 lakhs in 1951-52 and the estimates for 1953-54 has been for Rs. 107.4 lakhs. The rates on vehicles for carrying passengers plying for hire as introduced from 1st July 1951, have

been considered to be very high and burdensome, and the fares on public vehicles have also been increased as a result of such high taxation. The rates on the vehicles for the transport of goods have also been considered to be high, increasing the cost of transport to industry and trade.

The Sales-tax on petrol in West Bengal is now 0-6-0 per gallon and there is a Central Excise duty (or Import Duty) of 0-15-0 per gallon. The Chamber considers that the total commodity tax on petrol is thus very high and should be lowered by proper adjustment in these two levies.

Question 169.—Earmarking of Motor Vehicles tax for road maintenance and development.

The Motor Vehicles Taxation Enquiry Committee recommended that a portion representing 7 annas of the import duty on fuel collected by the Central Government should be earmarked for road development by transferring it to the Central Road Fund. That Committee also recommended that 4½ annas out of it should be allocated among the different States on the basis of consumption of petrol. The Chamber agrees with this recommendation, and it also holds the view that a portion of the States Sales-tax on Motor Spirit should be earmarked for maintenance and development of roads, such State pool being allocated among the local authorities. It should be ensured that such funds are actually spent for development and/or maintenance of roads.

Question 170.—Opinion on the recommendations of the Motor Vehicles Taxation Enquiry Committee of 1950.

The Chamber is in general agreement with the principal recommendations of the Motor Vehicles Taxation Enquiry Committee.

Question 171.—Taxation of Users of Roads other than Motor Vehicles.

The vehicles using roads other than Motor Vehicles have to bear certain fees levied by the local authorities. The Chamber is not in favour of further extension of taxation of these users.

Questions 172-175.—Entertainment Tax.

The realisation from Entertainment tax was only Rs. 7.6 lakhs in 1938-39 and Rs. 47.0 lakhs in 1946-47 in Undivided Bengal and the tax has been made to contribute roughly Rs. 110 lakhs during the last two or three years. The present rate of Entertainment tax in West Bengal is as under:—

RATE OF ENTERTAINMENT TAX IN WEST BENGAL.

Price of Ticket (Exclusive of Tax.)	Rate
Up to 0-3-0	Nil.
More than 0-3-0 but less than Re. 1	25 per cent.
More than Re. 1 but less than Rs. 3	50 per cent.
More than Rs. 3	75 per cent.

This steeply graduated rate was introduced from 1st April 1949, in place of the previous Schedule of rates which divided the tickets into 11 different slabs and the tax varied from 6 pies to Re. 1 on tickets up to Rs. 3-8-0, the tax on tickets of higher value being 1/3rd of the price. It would be thus seen that the maximum rate was 40 per cent. up to 31st March, 1949, in place of the present 75 per cent. The increase in the rates has thus been very steep requiring lower adjustments.

The Committee are not in a position to say whether the rates have reached the point of diminishing returns.

On revenue considerations, the question of uniformity in Entertainment tax cannot be pressed for at this stage of development of the country. After all, it is an indirect tax where the shifting of the incidence is comparatively easy.

Regarding graduation in the rate, the Chamber would like to suggest that the rate of Entertainment tax should not be as progressive as it is now in West Bengal. It would also urge upon the Commission to carefully consider whether it would not be better to replace the present graduated rate by a proportional *ad valorem* rate, with exemption up to a certain price of the ticket. That would also mean higher taxation of those who use better facilities for entertainment.

Question 173.—Exemption from Entertainment Tax.

The object for which the net receipts are applied should be the main criterion for exemption. The educational films should be exempted. The Chamber has no objection to exempting the lowest class of tickets from entertainment tax. The entertainment that may be provided only for children may also be exempted from tax.

TAXES ON CONSUMPTION OR SALE OF ELECTRICITY.

Question 176

The Electricity duty in West Bengal has been yielding higher and higher revenue to the State coffers. It yielded Rs. 57.6 lakhs only in 1946-47 in Undivided Bengal, and has been increased to yield Rs. 100 lakhs in the Budget for 1953-54.

On revenue consideration of the State, it appears that consumption or sale of electricity for domestic purposes may be subjected to small rate of tax in all the States.

The Chamber would, however, urge for exemption of industrial use of electricity uniformly in all the States.

Question 177.—Distinction for Domestic Use.

The Chamber considers that consumption of electricity on Frigidaires, Heaters, Radios etc., should be subjected to lower rates of tax. Such consumption is also charged at lower rates by the supplying companies.

The Chamber would also like to mention that in West Bengal, the State Government is extending electricity connections for domestic consumption in certain areas by taking the energy from private Companies and for such extension the Government rate is higher than the rate of the supplying companies. In such cases, exemption should be given to the domestic consumers even in respect of fans and lights.

Question 178.—Energy Used for Industrial Purposes.

The Chamber is not in favour of imposing duty on industrial consumption of electrical energy. It is a tax on production. If, however, the tax is at all continued, there should be no discrimination between such consumption by private undertakings and public undertakings. Secondly, smaller and newer enterprises should at least be exempted from this duty.

In this connection the Chamber would also like to mention that at present in West Bengal consumption of 15 or lower units is exempted from tax and the rate is 6 pies for each unit if the consumption is between 15 and 50 units. The rate on consumption of over 50 units is 0-1-0 per unit. The Chamber is not in favour of such graduations in the rate of electricity duty.

Question 179.—Differentiation between Public and Private Undertakings.

The Chamber is opposed to any differentiation between private and public Undertakings supplying electric energy. If, however, a Government Undertaking purchases the energy from a private Undertaking, and then supplies it to the private consumers, at enhanced rates, for covering the expenses of the Government Undertaking, then there should be no duty on such supply.

Question 180.—Uniformity among the Different States.

The Chamber does not consider it feasible except that the industrial consumption of electrical energy should be uniformly exempted in all the States.

Questions 181-183.—Betting Tax and Prize Competition Tax.

The yield from the Betting Tax was Rs. 10.3 lakhs in 1938-39 and Rs. 117.9 lakhs in 1946-47 in Undivided Bengal. The rate of the tax was reduced in December 1950 from 20 per cent. to 12½ per cent. and the yield in 1951-52 was Rs. 56.2 lakhs. The Chamber presumes that this adjustment in the rate was to avoid the operation of the law of diminishing returns in respect of this tax. The Chamber has no further comment to make about evasion of the tax or the advisability of increasing the rate. It has been suggested that lotteries, cross-word puzzles, riddle solutions etc., may be subjected to some sort of taxation.

PART VI.—LOCAL TAXATION

The issues involved in respect of local taxation were examined by the Local Finance Enquiry Committee. Before giving replies to some of the specific questions posed by the Commission, the Chamber would like to invite the attention of the Commission to the finding of the Local Finance Enquiry Committee that the overall average of local taxation works out in India to roughly Rs. 1-1-0 and as a proportion of the *per capita* National income the local taxes account for less than ½ per cent. It was also mentioned by the Local Finance Enquiry Committee that the burden of local taxes in England constituted 2.7 per cent. of the *per capita* National income in 1949-50.

From the figures collected by the Local Finance Enquiry Committee for the year 1946-47, it appears that in respect of local Taxation, the burden was Rs. 18-12-3 per head per year in the three City Corporation Areas, Rs. 4-11-10 in other Municipal areas and 0-4-1 in District Board Areas. It was explained in the Preliminary Memorandum of the Chamber (in paragraph 9 on page 32), that the bulk of the indirect and direct taxes are now borne by the urban population and from the figures mentioned here it would be found that the local taxes

on these very urban population are again considerably high in addition to the Central and State taxes. The Local Bodies excepting the City Corporations are mostly financed out of the State revenues which are collected principally from the urban areas. For example, in 1950-51, of the total Sales-tax of Rs. 5.2 crores collected in West Bengal, Rs. 4.2 crores was collected in the City of Calcutta; of Entertainment tax Rs. 72 lakhs in a State total of Rs. 105 lakhs; of Electricity duty Rs. 82 lakhs in a State total of Rs. 86 lakhs; and in State Excise, Rs. 306 lakhs in a State total of Rs. 620 lakhs. Of the other taxes also, Rs. 188 lakhs collected in West Bengal in 1950-51, Rs. 155 lakhs was collected in the City of Calcutta. The distribution of the taxes between the Cities and the *Mofussil* areas seems to be a little more even in the States of Bombay and Madras. In the opinion of the Chamber, the whole pattern of local finance should be examined by the Commission in order that some more funds required by the local Bodies in the rural areas may be raised locally.

For this purpose, wider powers may have to be given to the local Bodies for raising such funds, without hampering, however, free flow of goods and services among different regions within the State.

The Chamber agrees with the finding of the Local Finance Enquiry Committee that the scope of taxation by local Bodies in India is very limited. It appears that excepting the three City Corporations, all other local Bodies are being generally run principally on the doles received from the State Governments. The Chamber is in favour of changing this position and of ensuring certain sources of income to the local Bodies, both by reserving certain items only for local taxation and by apportionment of the yields from a number of States taxes, like Entertainment tax, Motor Vehicles tax, Petrol tax, etc.

In this connection, the Chamber would also like to observe that in a vast country like India, local Bodies have to be more relied on and the Directive principles of the Constitution also appear to have laid emphasis on building up the democracy in India from the bottom level of "Gram Panchayats". The local welfare services are required to be performed principally by the local Bodies and while it must be ensured that these services are rendered efficiently, it should be also ensured that adequate funds are available on a stable basis and independent of the likes and dislikes of the State Governments.

The Chamber agrees with the opinion of the Local Finance Enquiry Committee that "wholesale transfer of functions from local Bodies to State Governments is a retrograde step and should be avoided", and that "in the new set-up local Bodies will be used more and more as instruments of National policy and there would be a steady enlargement of their functions".

Questions 185-199.—Powers of Taxation.

About these questions relating to the powers of taxation of local Bodies, the Chamber generally agrees with the recommendations of the Local Finance Enquiry Committee about the sources of revenue the net proceeds of which should be made exclusively available for the local authorities. That Committee, however, envisaged establishment of convention for securing the object.

The Chamber does not favour the imposition of "terminal taxes on goods or passengers carries by Railway, Sea or Air". If, however, there is any such tax, it should be available to the local Bodies as recommended by the Local Finance Enquiry Committee.

As has already been mentioned, the Chamber would suggest the allocation between the State Governments and the local Bodies of the collections from Entertainment tax, Motor Vehicles tax, Electricity Duty and Petrol tax.

The Chamber has already mentioned that it is not in favour of making the local Bodies principally dependent upon grants-in-aid from the State Governments.

The Chamber does not favour the imposition of Octroi or Tolls by local Bodies and even if these are levied, it should be ensured that these do not impede the flow of trade and commerce among the different regions. So, such levies should be made on a uniform basis within a State.

It is a general complaint that local Bodies often fail to make full use of tax resources available to them, and before utilising their own sources, they ask for grants-in-aid from the State Governments. The Chamber is of the opinion that grants-in-aid should be allowed only in the last resort and if the financial resources are once scheduled for the local Bodies, then before sanctioning any grants-in-aid, a local Body should be required to prove that the internal resources have been fully utilised.

Question 201.—Valuation method for Property Tax.

The Chamber agrees with the recommendation of the Local Finance Enquiry Committee that "there should

be no change from the well-tryed basis of rent to the more or less uncertain basis of capital value". The rent should, however, be the actual rent recovered or recoverable. This basis should be uniformly followed in all the urban areas, and the Municipalities adopting the capital value as the basis should also gradually change to the rent basis.

Question 202.—Urban Immovable Property Tax.

At present this tax is levied only in two States of India, *viz.*, Bombay and the Punjab. The local Finance Enquiry Committee recommended that there should be obligatory provision for imposition of this tax by the City Corporations. The Chamber does not favour the imposition of an Urban Immovable Property Tax where it is not already existing. It would also suggest the scaling down of this tax where it is existing. The incidence of tax on property is already high in the Corporation areas of Calcutta and imposition of an Immovable Property Tax would prove too burdensome and would discourage building activities which are imperatively needed.

If, however, the tax is at all to be levied, it should be done by the Corporation. Multiplicity of taxes on urban property should be avoided and this is also another reason against the imposition of an urban immovable property tax in Calcutta or similar other urban areas.

Question 203.—Exemption from General Property Tax.

In the opinion of the Chamber, properties the rateable values of which fall below certain stated amounts should be exempted from taxation. This may be particularly necessary because of the fact that in many cases such properties may be the only source of living for the owners who may be widows, or even minors or disabled persons. In Calcutta, the Municipal Corporation can exempt from tax, at its option, properties the rental value of which does not exceed Rs. 50 per year. This limit appears to be rather too low and it may be increased to Rs. 250.

So far as the exemption of the charitable institutions, educational trusts etc. are concerned, the Chamber generally agrees with the recommendation of the Local Finance Enquiry Committee that the list of such institutions should be subjected to periodical review and each municipal body should maintain a list of such exempted institutions. In Calcutta, such exemptions require the sanction of the State Government. The Chamber, however, feels that Co-operative Housing Societies should not be entitled to such exemptions. The Chamber would also like to suggest that the properties used for educational, charitable, or religious purposes should at least be charged at concessional rates even though these may not be wholly exempted from the property tax. In Calcutta, land or building used exclusively for the purpose of public worship, burial or burning ground are exempted from the consolidated rate of the tax, and the exemption of land or building used for purposes of public charity may be given at the option of the Corporation.

On the question of remission for vacancy, the Chamber considers that the Bombay practice of remission to the extent of 2/3rd of the property tax, in case the property remains vacant for 60 consecutive days or more, should be introduced in all the States. The Chamber would particularly like to urge for exemption of new buildings during an initial period of at least two years from the date of completion of the building. Similar exemption has been also given in the Income-tax Law in order to encourage building activities.

Question 204.—Progression in Property Tax.

The Chamber is opposed to any progression in property tax. The Local Finance Enquiry Committee was not also unanimous on this issue. The income from property is already taxed progressively. The Income-tax Law and the Estate Duty would be another imposition on succession of property. The Local Bodies again should not therefore, go in for applying the principle of progression in taxing the properties. In Calcutta, a slab system exists for levy of the consolidated rate of property tax upon all lands and buildings. The graduation is as under :

Annual Value	Rate of Tax
Up to Rs. 1,000	15 per cent.
Rs. 1,001-3,000	18 per cent.
Rs. 3,001-12,000	22 per cent.
Above Rs. 12,000	23 per cent.

It is also provided under the Calcutta Municipal Act 1951, that where the annual valuation exceeds Rs. 3,000 the maximum percentage may be increased up to 23 per cent with the approval of the State Government. The

actual levy of the consolidated rate is determined annually subject to the above mentioned graduations. It has been stated that the Calcutta Corporation loses a sum of about Rs. 15 lakhs a year for the benefits given to small buildings. The Commission may, therefore consider whether a proportional rate may replace the present progressive rate.

Question 205.—Authorities to levy Property Tax.

All categories of local Bodies should have the power to levy property tax within their respective jurisdictions. But the maximum and minimum rates may be fixed at State levels.

Question 206.—Procedure of Assessment and Collection of Property Tax.

The assessment of Property tax has been considered to be often arbitrary, particularly for local Bodies other than City Corporations. The arrears of collection have also been reported to be always heavy. The assessment should be made by all the local Bodies within a State, on some uniform principle, and better administration can only diminish arrears of collection.

Question 207.—Service Taxes *vis-à-vis* Properties of Public Bodies.

The Chamber does not consider it objectionable to levy service taxes on the same basis as the general property tax. In fact, such service taxes like those for water supply, street lighting, drainage and conservancy etc. may be consolidated with the property tax. If, however, the different areas within the same Municipality obtain different treatment in respect of the services or if the rate-payers in certain types of properties do not get the services as others then the consolidation of service taxes with the property tax may reasonably be objected to. In such cases the effort should be to extend the services on a uniform level rather than going in for differential taxation.

The Chamber does not find any justification for preferential treatment towards the properties of the public bodies like, the Port Trust, Railways, Central Government and State Government. The properties of such public bodies should be subjected to the same rate of property and service tax as applies to other properties.

Question 209.—Octroi and Terminal Tax.

The Chamber is not in favour of Octroi and Terminal Taxes. The imposition of these taxes creates artificial barriers in the free flow of trade.

Question 210.—Substitution for Octroi and Terminal Taxes.

The Chamber does not favour the levy of surcharges on Sales-tax by the local Bodies as suggested in the Question. In its opinion a portion of Sales-tax may be divided among the local Bodies on the basis of collection.

Questions 211-213.—Octroi and Terminal Taxes.

The Chamber has already pointed out that it is opposed to levy of Octroi or Terminal taxes.

Question 214.—Extension of the Nationalisation of Motor Transport.

The Chamber does not favour further nationalisation of Motor Transport. The State Transport Organisation in West Bengal has been a losing enterprise. The Chamber is opposed to the terminal taxes and therefore the question of facilitating its collection by nationalisation of Motor transport does not arise.

Question 217.—"Pilgrim" Tax and Taxation of Floating Population.

The Chamber does not like to make any comment on "Pilgrim" Tax.

It would, however, like to mention that the question of some sort of taxation of floating population who daily come to the City areas is very important for the Cities like Calcutta. The last Census has disclosed that only some 25 lakhs of the people inhabit the City of Calcutta in the night whereas it has been estimated that not less than two lakhs of people come daily to Calcutta through the two Railway Stations alone and the passenger traffic within the City has been estimated to be roughly 45 lakhs. All this vast concourse of people put serious strain on the City. The Calcutta Corporation has to provide amenities for all these floating population. The Commission may kindly examine the feasibility of collecting some tax from this floating population for the benefit of the big cities like Calcutta.

Question 218.—Poll Tax.

The Chamber does not consider it feasible to levy a Poll Tax in India whether as a form of local and/or State tax. A Poll tax is not considered to conform to

modern concepts of justice in taxation. Within a local area, such a tax may secure some contribution from the local people for local development and in the U. S. A., the Poll tax gained ground during recent years as a revenue raiser for small and medium units of local Government. But there too, it has been considered that the contribution of the people in general to the Government or a local Body may be secured through other measures. The Poll tax being a direct tax on every person may also be an unpopular measure, which the local Bodies may not like to resort to. A Poll tax in rural areas payable either in money or by labour or service may however secure the participation of the local people in local developmental and welfare activities.

Question 220.—Raising the Constitutional Limit of Profession Tax.

A. The Constitution lays down the limit of profession tax in a State at Rs. 250 per head per annum. In view of the high load of income-tax, the Chamber does not consider that this limit should be increased.

Question 228.—Contribution of Labour as Payment for Tax.

A. In its preliminary Memorandum submitted to the Commission, the Chamber explained that if the services of the local people could be secured for local development, the revenue needs of the Government might be diminished and thus such services might be considered as service taxation. The Planning Commission in paragraph 34 of their Report also emphasises that "there are a variety of ways in which idle manpower and spare hours of those partially employed can be canalised into a Nation-wide programme of developmental activities. In the digging of canals, repair and renovation of tanks, construction of roads, bridges and bunds, rural housing, improvement of sanitation, in the imparting of elementary education and technical training and in several other activities, there is scope for participation of all sections of the population". The Chamber therefore feels that such participation can be made possible if provision is made for payment of certain taxes in terms of manual labour or service.



BOMBAY CHAMBER OF COMMERCE.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART I.—THE TAX SYSTEM

Question 1.—What, in your opinion, should be the objectives of a sound tax policy? What should be the place in such a policy of the following objectives:

- (a) reduction in inequalities of income and wealth;
- (b) encouragement of incentives to work, to save and to invest;
- (c) countering of inflationary and deflationary tendencies; and
- (d) maintenance of the external balance of the economy?

In what directions would you suggest modification of the Indian tax system having regard to these objectives?

The main objective of a sound tax policy must be to increase production and so raise the standard of living. If the main objective is to be realised

- (a) the taxable capacity must be fairly determined, taxation accordingly imposed, and thereafter not increased; certainty and stability are essential if capital is to be made available for investment in whatever sectors of the economy;
- (b) there must be a competent administration; the machinery for the collection of revenue must be effective otherwise taxation must be increased beyond the taxable capacity.

If there is incentive to work, to save and to invest there will be an accumulation of wealth by personal or community effort and production; from that accumulation the appropriate quantum can be channelled by taxation to the revenue. But if accumulations are to grow and production expand, the quantum of the accumulation left in the hands of the individual or the community must be such that the assets with which the wealth is created can be maintained in a condition in which they may continue to increase.

Savings and investment must be encouraged by all possible means but without direction of savings into particular channels; the risk differential will operate to ensure that available resources will be correctly employed. The reactions of the natural laws of supply and demand will control the inflationary and deflationary tendencies in the economy and it should not be the objective of taxation policy, as distinct from monetary policy, to attempt to regulate supply and demand. If the inflationary and deflationary tendencies are allowed to adjust themselves, the external balance of the economy will automatically find its own level.

It may be necessary, at times, to resort to controls, physical and monetary, but controls should not be regarded as an inevitable constituent of an overall State policy. Controls should be used only to deal extraordinary circumstances which have disrupted the working of the natural economic laws since they are usually too late when imposed or revoked to effect a cure.

In a country dependent upon exports of primary products for its external balance of trade, taxation of the exportable product must be such that it is not priced out of its markets whether by direct internal taxation or by export duties. Export duties may destroy the competitive power to sell in world markets. The levy of an export duty on commodities which enjoy a monopoly or near monopoly in source of supply, (e.g., jute and manganese) causes overseas buyers to look for substitutes or to seek alternative sources of supply. The first has happened in the case of jute and the second is about to happen in the case of manganese. The principle should be to sell at the best price obtainable in the export market leaving it to well-organised trade associations to adjust their production, selling arrangements and prices in a market which they understand and which, for their own benefit, they will do everything to preserve.

While the reduction of inequalities of income and wealth is desirable it cannot be a primary objective since in the result over-all living standards may thereby be reduced.

Taxes should be levied over the whole population, equitably according to ability to pay but in no case so severely as to impair incentive. A sound tax policy will not destroy the incentive to work, to save and to invest; the Indian tax system, in the opinion of the Chamber, should be modified in a number of ways as indicated in the Chamber's replies to other parts of the questionnaire.

Question 2.—What criteria would you suggest for determining the equity of a tax system? How far is it possible to secure it in the Indian tax system?

Question 3.—Does the Indian tax system conform adequately to the principle of ability to pay or do you think an extension of this principle is desirable and practicable? If so, in what ways?

Question 4.—Differing views have been expressed on the extent to which the taxable capacity of various sections of the community has been used by the Indian tax system. What is your view on the subject?

A tax system should be simple, plain and intelligible to all, whether they fall within its incidence or not; the imposts should be easy to calculate and to collect; liability should be apparent and determinate; evasion should be as nearly impossible as human ingenuity can devise. The severity of the levy should not normally exceed the revenue needs of the State and capital undertakings should normally be financed by loans. Schemes, however presently desirable, must be carefully co-ordinated to available finances whether from taxation or loans.

So long as incomes from agriculture are exempted from charge to income-tax it cannot be said that the system conforms adequately to the principle of ability to pay. An extension of the principle is to that extent at least desirable and practicable.

The present tax system in India developed during times when ease of collection was undoubtedly the paramount consideration. That resulted in a concentration of the tax burden on the salaried classes, trade and industry. The agricultural and industrial labouring classes were disproportionately poor and were largely untaxed except in so far as indirect taxes on consumable articles (e.g., salt and kerosene) affected them. Agricultural land-owning classes were not subjected to income-tax because they paid land revenue which was subject to periodic revision at fairly long intervals. In some States even land revenue was fixed (Permanent Settlement in Bengal and Orissa). The revenue payable was in any case based on an average computation of the value of the land and otherwise took no account of the value of the produce from year to year. The redistribution of wealth caused by the effects of war on world conditions has resulted in a much greater proportion of the national income finding its way into the pockets of both the labouring classes and the agricultural population. The latter class have been benefited by the rise in the prices of primary products which have risen proportionately more than the cost of living in rural areas. The effect on industrial labour has been less marked.

The rise in prices of primary needs (food, clothing and fuel) resulted in labour unrest but, by wage increases, industrial awards transferred a larger proportion of the purchasing power of the country to the hands of labour. Industrial labour, which now receives about four times the wages formerly earned, is still largely unaffected by taxation which falls mainly upon the salaried classes whose incomes are not adjusted in the same ratio. In the result the incidence of taxation has fallen disproportionately on the middle class urban population.

The need for development and social services has resulted in higher taxation much of which has not touched large sections of the population. The major portion of tax revenue is to be raised in indirect form from those who are taxed only indirectly. The revenue is to be expanded only by raising their consumption levels.

Agricultural incomes which have hitherto escaped should also be charged to income-tax equitably with incomes from other sources.

During and after the war, there was clear need to extract a substantial proportion of the inflationary potential; to that end the level of direct taxation was raised. A combination of high prices and high taxation has destroyed the ability to save; personal savings in middle-income groups have reached vanishing point. In upper-income groups constituting an infinite small percentage of the population, the super-tax limits are so high that their savings have also considerably declined. The limit of capacity has been reached.

Question 5.—The proportion of tax revenue to national income in India is considered small relatively to several other countries. Do you think this proportion can be raised, and, if so, what tax changes would you suggest for the purpose?

Revenue can only come from a surplus over subsistence. This surplus in India is much smaller than in other countries and therefore a comparison of the proportion of national income taken by taxation in India with that of other countries is invidious. The proportion of taxation to the national income can only be raised by increased production resulting in a higher *per capita* income.

Question 6.—Do you think that the relative place of direct and indirect taxes in the Indian tax system is satisfactory?

All direct taxation is contributed by only about 800,000 of income-tax assesseees, representing three in one thousand of the population. There will be a healthier ratio between the two when the number of persons contributing in direct form is increased as a consequence of raising living standards.

Question 7.—Do you consider that non-tax revenues are likely, in future, to occupy a more important place than hitherto in the public revenues of India? If so, please state the sources of non-tax revenue you have in view and indicate to what extent they may be expected to contribute to the public exchequer.

It is declared policy that State enterprise should, subject to the limitations of a mixed economy, operate in a wider field, and accordingly it is reasonable to suppose that if efficiently conducted and intended to produce revenue it will make a larger contribution which will however, be in part offset by a loss of revenue from the sphere of private enterprise where that has been intruded upon.

Question 8.—Do you agree with the view that receipts from particular taxes should not, as a rule, be funded or ear-marked for specific purposes?

The Chamber is generally opposed to an appropriation of tax receipts to expenditure for specific purposes since that may result in uneven and inequitable expenditure or its non-use.

Question 9.—Do you think that it is desirable, under certain conditions, to levy cesses for special purposes?

It is not desirable to levy cesses for special purposes. There are special cesses levied on sugarcane, tea, rubber and other commodities, the income from which is earmarked for specific purposes such as research and development. Very little has been spent for the specific purposes and substantial portions have been diverted to general revenues. A clear example can be found in the case of cess on sugarcane, which is collected by U. P., Bihar and Bombay. Collections under the U. P. and Bihar Cess of 3 annas per maund (15 per cent. of the cost of cane) amount to over Rs. 30 crores while the sums spent on cane development have been negligible. In 1948-49 the U. P. Government spent only Rs. 37 lakhs out of Rs. 3-17 crores collected while in 1949-50 the Bihar Government spent only Rs. 13 lakhs out of Rs. 70 lakhs collected.

It is still less desirable to levy a cess to subsidise another branch of the same industry, thus increasing the cost to the consumer.

Question 10.—State undertakings, commercial industrial, etc., are coming to play an increasingly important part in the economy of the country. Have you, from the point of view of their significance as a source of revenue, actual or potential, any comments or suggestions to make on matters such as the further extension of State undertakings and their policies in regard to pricing, in so far as these may be relevant to tax policy?

The relevance of State undertakings to tax policy can only be considered in the context of the economy contemplated by the Planning Commission, namely a mixed economy in which the public and the private sectors function side by side. It follows, therefore, that if there is to be a correct appreciation of the contribution which these undertakings are making or can make to the financial resources of the State, they should be taxed on the same basis as private enterprise and their accounts should be kept accordingly.

State undertakings must therefore function in all respects on the same terms and conditions and in the same 'milieu' as private undertakings. This is particularly important when, as in India, the spheres in which State undertakings operate do not cover the totality of a particular industrial field. Thus, whereas, for example, the State is engaged in a particular branch of the pharmaceutical industry, sharing the field with private enterprise, it is essential that the bases of computation of costs should be the same in order that comparable price policies may be followed. The same applies to State-owned collieries and power supply corporations which operate side by side with private enterprises of the same kind.

The operations of State undertakings must in all respects conform to normal commercial practice; they should be subjected to the same tax burdens as similar

units operating in the private sector; their accounts should be subjected to the same scrutiny by the Income-tax Department, and their balance-sheets should be available to the representatives of the proprietors (i.e., the Legislature) in the same way as are those of private enterprise. In any other condition the Legislature is prevented from exercising proper control and there is danger that uneconomic activities will be concealed by hidden subsidies.

Question 11.—Would you suggest that the net surplus earned by State undertakings should accrue to general revenues or be carried to a fund for financing projects of development or be re-invested in the undertakings concerned?

The State is entitled to receive only the net surplus available after meeting taxation and making such appropriations as would be considered necessary by a comparable unit operating in the private sector. The entire surplus should not be transferred to general revenue nor to a fund for financing other projects. No corporation operating in the private sector disburses its total earnings in the form of dividends. Such a policy would inevitably lead the undertaking into difficulties; there is no reason why a State undertaking should not set aside reserves against future contingencies and for development simply because the method by which its capital is raised (i.e., by a vote of the Legislature) is different from that to which a private enterprise must have resort. The funds of the enterprise should be employed only for its own development.

Question 12.—In examining the incidence of taxation on various classes of people, which of the following factors, singly or in combination, would you suggest as the basis of differentiation:—

- income
- occupation
- rural or urban residence?

Is there any other basis which may be considered?

Income levels alone should be the criterion in examining the possible incidence of taxation by Central and State Governments on various classes of people. In respect of taxation by municipalities or local boards, the criterion will normally be the services rendered.

Question 13.—Do you think that the burden of the present tax system Central, State and Local—is fairly distributed among—

- various classes of people?
- different States?

The burden of the present tax system, Central, State and Local, is not fairly distributed amongst various classes of people and between different States. In the case of Central taxation, the agricultural income is not brought within charge to income-tax which is imposed on non-agricultural income exceeding Rs. 4,200 and the privy purses of ex-rulers of Indian States are exempt. As a result of the existing burden of taxation coupled with the rise in the cost of living middle-income groups are left with relatively much less real income than the other two groups.

In the case of State and Local taxation there is a great disparity between different regions. Moreover, it must be pointed out that a State that collects higher taxes does not necessarily offer proportionately higher benefits to its people.

Question 14.—Have shifts in the distribution of income in the community in recent years altered the relative incidence of taxation on various classes of people? If so, to what extent?

The ground seems to have been covered in our replies in earlier questions.

Question 15.—Do you think that the cost of compliance with tax regulations adds materially to the burden of taxation? If so, in respect of what taxes? Please give details.

The tax laws are complicated and the personnel employed in their administration inadequate and frequently inefficient. The cost of compliance does add materially to the burden of taxation; for employment of considerable personnel is required, in effect reducing the surplus available for taxation and consequently increasing the tax burden.

The cost of compliance with Customs and import regulations is increased by reason of the lack of co-ordination between the classification of items under the Indian Customs Tariff and the Import Trade Control; much time is expended in resolving these differences. There is wide scope for simplification and clarification in this field.

The resolving of varying interpretations of the Sales Tax Act in different States puts an appreciable financial burden on those concerned and particularly on corporations resident in one State but trading all over India who are called upon to file statements and produce account books before various State authorities. Town

Duties and Octroi require an administrative expenditure which adds materially to the cost of production.

The cost of compliance with a complexity of tax regulations adds materially to the burden of taxation, particularly in regard to the maintenance of elaborate records and accounts to meet the requirements of :—

- (i) complicated and involved tax legislation ;
- (ii) varying regulations between different authorities in the methods of assessment ;
- (iii) the untrained personnel responsible for their administration.

Question 16.—Do the benefits accruing from public expenditure have a bearing on a consideration of the burden of taxation? If so, how would you take this into account in considering the burden of Indian taxation?

Where an increase capable of assessment accrues as a consequence of the expenditure, as in the case of irrigation, it would be appropriate to recover a part of the income through taxation.

Question 17.—Do you think that the tax burden weighs particularly heavily on any individual industry or occupation? If so, please furnish the Commission with the evidence on which you rely.

The tax burden falls particularly heavily on the professional class who are denied the benefits of incorporation and consequent capital development through profit retention, and whose provision for retirement and succession must be found from income taxed at high rates. Reference may be made to the Chamber's reply to Question 65 at Part II. Another example of disproportionate taxation is the trade in wines and spirits.

Question 18.—What role would you assign to taxation vis-à-vis various types of borrowing in finding the additional resources required for the development programme of the country?

Ideally where schemes of development are undertaken for lasting benefit not only for the present generation but also for coming generations some balance must be struck between the resources to be obtained through taxation and through borrowing so that the present generation bears only its appropriate share of the cost.

In present circumstances the Government's policy seems to be to obtain as much money as possible through taxation because of its anti-inflationary character and because the response from the capital market to the borrowing programmes of Central and State Governments has not been up to expectations. That is to say what is not given voluntarily by subscription to loans is taken through taxation. If the borrowing programme can be adopted to mobilising savings which to-day do not flow into the regular investment channels, then the present practice of obtaining funds through taxation for long-term projects could and should be modified.

Question 19.—In maximising the resources required for the financing of development, what degree of importance would you assign to :

- (a) economy and rationalisation in expenditure,
- (b) prevention of tax avoidance and tax evasion,
- (c) higher rates of existing taxes,
- (d) fresh taxes,
- (e) development of non-tax revenues?

The burden of taxation should not retard the processes of development and the administrative machinery must be competent to collect the taxes levied; the prevention of tax avoidance and evasion must occupy a place of first importance in measures for maximising the resources required for development. For, if evasion is resorted to on any wide scale the result must inevitably be that the taxing authority will seek to increase the burden of taxation still further in order to make up the shortfall. A snowball effect will result, so that in the end the burden of taxation will retard the processes of development.

In order that tax avoidance and evasion be reduced to a minimum, it is essential that the tax laws be simple, intelligible and precise; that those administering the laws treat assessee with sympathy and understanding and last, but by no means least, that assessment work be speedy and up to date. None of these conditions obtains to-day with the result that appreciable sums which should have reached the exchequer have not, and are not likely to do so. The need for a revitalising of the administration cannot be too heavily emphasised.

Once the taxable capacity has been determined and the tax collected, it follows that there should be strict economy and rationalisation in expenditure. The subject is entitled to the utmost care and economy in the expenditure of his contribution to the revenue.

Only when it is clear that the taxes at the existing rates are being effectively collected should any increase be considered, subject to the law of diminishing returns.

Fresh taxes should be resorted to only when all possible methods of broadening the coverage of the existing taxes have been explored or to take cognisance of shifts in the distribution of income in the community.

Question 20.—Under the Five-Year Plan the public sector is expected to undertake a larger investment; an important place is also assigned to the private sector in the development programme. How would you devise a tax policy suitable to the development programme of the country in both sectors?

Question 21.—What part can tax policy play in stimulating capital formation in the private sector consistently with the needs of the public sector?

There is a limited pool of available resources for which the public and the private sectors must compete. So long as the incentive to produce and to save is overborne by rates of taxation which are considered oppressive both sectors of the economy will finance schemes for development only with difficulty. The incentive must be increased by tax relief which will create savings exceeding the immediate loss of revenue. Reference may be made to the Chamber's submissions made at Part II.

Question 22.—(i) Is there evidence for the view that the rate of private capital formation in the community has been lower in the last few years as compared to the pre-war period? What factors, in your opinion, account for the decline?

(ii) Has there been a shift in recent years in the sources of capital formation in the private sector as between individuals, corporations, and other institutions?

In the absence of reliable data there is no evidence to show that the rate of private capital formation is lower than in the pre-war period although it is clear that there has been a substantial decline in the number of issues for public subscription made since 1946. The increase in the volume of industrial production would, however, appear to support the view that there has been a corresponding increase in capital formation in the private sector which may very well have been larger but for Government policies with particular reference to control and regulation, nationalisation, labour and imports. Government policies apart, the uncertain supply position and the high cost of capital equipment has been a deterrent factor, as also the partition of the sub-continent.

There has been a shift in net income distribution. Middle and upper-middle income groups have little or no savings whereas only institutional and corporation savings from profit retention are available for investment.

Question 23.—Do you think that tax relief in respect of persons in the middle-income group would assist the growth of savings or mainly promote consumption?

The middle-income group includes what were formerly known as the lower and upper-middle classes both of whom by tradition were accustomed to save. No saving is now possible either because of the high cost of living or of high taxation or a combination of both. In any event the incentive to save has been at least partly destroyed. At the bottom of the scale there is a psychological reluctance to save so little that it seems not worthwhile. At the other end the net return from the saving's investment is not adequate compensation for self-denial and the risk of capital. If there is a worthwhile saving and a reasonable net return from its investment there will be no substantial increase in consumption.

Question 24.—The Planning Commission have given an estimate of the rate of progress in regard to national income and consumption standards on the assumption of 50 per cent. of the additional output going into investment each year after 1956-57. What measures in the field of taxation are necessary if this assumption is to be realised?

A substantial part of the value of the additional output must necessarily be retained and go to increase the standard of living of persons who now make little or no contribution to revenue through either form of taxation. The remainder will accrue to persons and corporations whose increased contribution to revenue will automatically follow. Many in the first class may contribute through irrigation and betterment levies but it would not be unreasonable to increase or extend such indirect taxation as affects or will affect this class.

Question 25.—Do you accept the view that some regulation of consumption standards is desirable as a means of releasing larger resources for development? If so, what part, in your view, can tax policy play in this process and what should be the relative role of direct and indirect taxes in achieving the purpose?

While it is desirable that the largest possible proportion of resources should be available for development an increase in consumption may also be desirable where the standard of consumption may be judged to be too low. Impetus is thereby added to production. If denied the incentive to work may be impaired.

Question 26.—How far can tax policy help to promote the efficiency of the productive system? Do you think that multiplicity of taxes in India in respect of the same commodities and their lack of uniformity from State to State affect the allocation of resources in the community and hence the efficiency of the economy? Have you any suggestions for the rationalisation of the country's tax structure in these respects?

Any productive system is just as efficient as the tax policy will allow. Reference is frequently made at other parts of the Chamber's submission concerning the need for a reduction of the multiplicity of taxes and a uniformity of tax rates and their point of incidence throughout the Union.

Question 27.—How far in your view could the tax system be used to secure any order of priorities in the development programme in the private sector?

The question suggests a taxation differential for certain industries. Such a differential already exists through Sections 15C and 56A of the Income Tax Act. It is the Chamber's opinion that any increase in production is to be encouraged. There should be no differential.

Question 28.—What are the possibilities and limitations of tax policy as an instrument for economic development:—

- (a) by influencing over all demand,
- (b) by reducing consumption and unessential investment,
- (c) by positive inducements for desirable investment,
- (d) by redistribution of incomes.

The overall demand may be increased by a lowering of indirect taxation and consumption reduced by its being increased.

Unessential investment is best regulated through monetary controls so that only desirable investment is permitted and encouraged through a reduction in direct taxation, although the relief must extend also to existing industry. A tax policy operating as an instrument for economic development must necessarily tend to increase inequalities of income.

Question 29.—How would you assess the scope and efficacy of tax policy as compared to monetary policy and direct controls as an instrument of planned economic development in India?

A judicious blend of tax and monetary policies is the only means by which planned economic development can be promoted. Without savings, a monetary policy, with its concomitant controls, can produce nothing.

The instrument of direct controls should be used only to ensure equitable availability of essential commodities at times when the operation of the natural economic laws has been disrupted by extraordinary circumstances.

Question 30.—Do you think that the present tax system in India makes for a reduction in inequalities of income and wealth?

Question 31.—What modifications in the tax system would you suggest for securing a larger degree of economic equality, consistently with maintaining the incentives to capital formation and higher production?

Question 32.—What place would you assign to public expenditure as compared with the tax system in achieving a greater measure of equality of income?

The present tax system goes too far to reduce inequalities of income and wealth. Such is the way to economic suicide, for it reduces the industrious subject to the common level. In order to secure a larger degree of economic equality the overall living standard is to be raised through increased production in a condition in which there is incentive to work; the modifications necessary are discussed by the Chamber's submission in reply to Part II of the questionnaire.

Public expenditure may include the cost of social services, having the effect of raising the standard of living but not of equalizing incomes. In the Chamber's opinion there is no substitute for the tax system as the instrument by which a greater measure of equality of income is to be achieved.

Question 33.—Have you any changes to recommend in tax policy in relation to the investment of foreign capital in India?

It is prerequisite to the attraction of foreign capital that

(a) India should negotiate and conclude agreements for the avoidance of double taxation with the principal exporting countries;

(b) the status of the corporation tax is rendered less nebulous by its being credited as a payment of income tax made on behalf of the shareholder;

(c) the rate of tax suffered by foreign capital on profits, interest and royalties should be no greater than that imposed on Indian capital; the tax on dividends payable by Indian companies to foreign shareholder-corporations should be reduced by the allowance of the maximum corporation-tax abatements;

(d) section 23A of the Income Tax Act should not apply to a subsidiary or sub-subsidiary of a foreign company in which the public are substantially interested.

Question 34.—Article 269 of the Constitution enumerates the following taxes which may be levied and collected by the Union but the proceeds of which are to be assigned to the States;

- (a) duties in respect of succession to property other than agricultural land;
- (b) estate duty in respect of property other than agricultural land;
- (c) terminal taxes on goods or passengers carried by railway, sea or air;
- (d) taxes on railway fares and freights;
- (e) taxes other than stamp duties on transactions in stock exchange and future markets;
- (f) taxes on the sale or purchase of newspapers and on advertisements published therein.

How do you assess the possibilities of adding to the country's tax resources in respect of the above items?

Question 35.—Other possible ways of adding to tax receipts which have been suggested are taxes on capital, reintroduction of the salt duty, surcharges on land revenue, betterment levies, agricultural income-tax, social security taxes and modification of the policy of prohibition having regard to the directive principles of the Constitution. What are your views regarding the desirability and the probable scope of each of these forms of taxation?

Question 36.—Do you consider it desirable and feasible to levy a tax on unearned increments in value of land and other property as a result of public projects of development?

Question 37.—What measures would you suggest for increasing the receipts from existing sources of revenue?

Question 38.—What other new sources of taxation can you recommend?

The Estate Duty Act recently passed by Parliament clearly carries a potential for increased revenue. Reference may be made to the Chamber's submissions made in reply to other question concerning possibilities for additional revenues. The possibility of raising revenue through State lotteries was considered and rejected some years ago. The potential for increased revenue and the saving of the cost of enforcement upon resiling from or modifying the policy of prohibition adopted by a number of States is obvious.

Question 39.—To what extent and as regards what taxes should the powers of the Centre to impose surcharges under Article 271 of the Constitution be used?

The Centre should impose surcharges only as may be absolutely necessary, and then so that they are operative only until the next following 1st April.

Question 40.—What are the scope and limitations of tax policy as an instrument for dealing with inflationary or deflationary situations in Indian conditions?

In a country whose economy is highly developed tax policy can be used as an instrument for dealing with inflationary or deflationary situations. But in Indian conditions there are serious limitations to the use of direct and indirect taxes for their correction. During the past decade both direct and indirect taxes were used to counteract inflation. Direct taxation was raised to a maximum but there was considerable tax evasion. Direct taxation in any event affects only a fraction of the population, whereas inflationary pressure arises from all incomes.

Indirect taxation as, for example, the multipoint sales tax is very definitely inflationary. In a deflationary condition, however, a reduction in indirect taxation will reduce costs, thereby increasing consumption and stimulating exports. But it has been found by experience that fiscal considerations do not permit rapid adjustment in taxation, especially in deflationary conditions, when revenues from other sources are declining.

Question 41.—*In countering inflationary or deflationary conditions in the economy, what part would you assign to changes in the following :*

- (a) direct taxes,
- (b) indirect taxes—
 - (i) import duties,
 - (ii) export duties,
 - (iii) excise duties,
 - (iv) sales tax ?

Until the per capita income is higher and many more incomes can be brought within the compass of direct taxation, its raising or lowering can have little effect on inflationary or deflationary conditions.

Indirect taxation is a potential for the correction of inflation only when imposed at rates causing a diminution in returns. Any reduction in indirect taxation must tend to correct deflation.

Question 42.—*To what extent is it possible to increase the inherent capacity of the tax system to counter-act inflationary or deflationary conditions in the economy ?*

In a country where so many live so closely to the subsistence level the tax system has barely any potential for the control of inflation or deflation.

Question 43.—*What are your views in regard to the relative importance of public expenditure policies in moderating the forces of inflation and deflation in Indian conditions ?*

Public expenditure, whether in the sphere of development works or social services is too inflexible an instrument for the effective control of inflation. Neither can be readily abandoned or curtailed. On the other hand, expenditure on planned public works may be undertaken as a corrective to deflation.

Question 44.—*Apart from using tax policy to counter inflation or deflation in the economy as a whole, would you suggest tax changes for dealing with the effects of rising or falling prices on particular groups of tax payers or sectors of the economy ?*

Quite clearly the effects of rising or falling prices on particular groups of taxpayers may be offset by adjustment of the rates of direct taxation at the appropriate levels. Similarly the incidence of indirect taxation may be increased or reduced by an adjustment of the levies imposed on different sectors of the economy.

Question 45.—*How do you assess the present situation in regard to the strength of inflationary or deflationary influences and what adjustments, if any in taxation are indicated in the light of your views ?*

Much of the excess liquidity generated during the period of war and in the immediate post-war period has been removed. Present high prices, particularly of basic necessities of life like foodgrains, are the result of an increase in consumption and of recurring shortages ; as a consequence the cost of living remains at an unduly high level. The existence of inflationary pressures is not thereby necessarily proved ; there is a lack of balance between demand and supply of the necessities of life. Many economic processes show signs of slackening activity ; growing unemployment is a definite sign of the presence of deflationary influences. Owing to the high cost of living and the high incidence of taxation, both direct and indirect, personal incomes as well as corporate profits have been reduced. That will further accentuate the downward trend in the economy. Taxation reliefs will go some way to correcting the position.

PART II.—DIRECT TAXES

INCOME-TAX

Question 46.—*Do the provisions of the Income-tax Act (Sections 4A and 4B) regarding the determination of residence of various assesseees, viz., individual, Hindu undivided family, firm, association of persons and company, require any modification ? In particular, what is your view regarding the retention of the category described as "not ordinarily resident" ?*

Persons technically 'resident' or 'not resident' in the taxable territories may at the same time be 'not ordinarily resident'. Falling into this third category are those whose way of life does not mainly or normally lie in the taxable territories. Subject to certain exceptions they are free from charge to the tax in respect of foreign income. There seems to be no reason to abolish the category although a clarification of the language of its definition is desirable ; the freedom from charge is equitable enough and is not inconsistent with the position in other countries.

On the other hand the States are now merged in the taxable territories of India and there appear to be logical grounds for the proposition that the category may reasonably be extended to a company technically

resident only according to alternative (b) of the definition of residence of a company at section 4A (c). Income accruing or arising abroad not received in the taxable territories would be taken out of charge to the tax in the case of a company not wholly controlled and managed in the taxable territories but whose whole profits are now brought within charge by the artifice of the definition's alternative which is contrary to international usage and in effect gives the statute extra-territorial jurisdiction although under sanction of the law.

The employee of foreign enterprise, whose stay in the taxable territories extends beyond the limitation of the exemption period prescribed at section 4 (3) (xiv) but for less than 182 days in any year, in respect of the period by which his stay exceeds 90 days but is less than 182 days, or a person coming to India to take up employment in a trade or business in the taxable territories, in respect of a year in which he has not been in the taxable territories for 182 days, is to be taxed as a non-resident. In case he exercises the option provided for at section 17(1), he is to be charged to the tax on income accruing, arising or received in the taxable territories at the rate applicable to his total world income. A person may be not resident and at the same time not ordinarily resident but the benefit of the status of being not ordinarily resident is denied, by reason of the provisions of section 17(1), to the two types of persons described. That benefit is enjoyed by persons who have come to India for employment or business but whose stay has extended to 182 days but not to two years in all. There is not such a degree of difference in status between the class of person entitled to the exclusion from total income of income accruing or arising abroad and the class of person not so entitled ; it is thought specific provision may be made so that the person who has come to India for employment or business and not merely on a casual visit may also enjoy the benefit of the not ordinarily resident status for so long as he is in the taxable territories for less than two years.

Question 47.—*Does the definition of "income" (section 2 (6C)) require any modification ?*

Section 2 (6C) is not a definition of income nor is an exhaustive definition of the term possible. The section merely seeks to ascribe the character of income to certain incomes both real and notional not normally falling within its conception. What is or is not otherwise income must always be a question of law. Reference is made at other parts of this submission to the dividend inclusion in income and to the need to bring incomes from agriculture within charge to the tax. Subject thereto the definition requires no modification excepting only to include the notional income to be computed according to the prescription at the fourth proviso to section 10(2) (vii).

Question 48.—*Are there any receipts or gains which are not taxed at present but which, in your opinion, should be taxed and vice versa ? In particular, what is your view regarding the taxing of capital gains ?*

The context of 'income' at section 2 (6C) of the Act includes everything that is or may reasonably be deemed to be income.

Income is a proper subject of taxation ; the tax on income is generally accepted as the most equitable of all taxes. Only when all proper subjects of taxation are exhausted must the State resort to the taxation of improper subjects.

According to Mills, there is no tax which is not partly paid from what would otherwise have been saved ; no tax, the amount of which, if remitted, would be wholly employed in increased expenditure, and no part laid by as an addition to capital. All taxes, therefore, are in some sense partly paid out of capital ; and in a poor country it is impossible to impose any tax which will not impede the increase of the national wealth.

A tax on a capital gain is bad in a condition in which all of the ordinary kinds of income are taxed to the limit of the capacity of the subject leaving no margin for savings.

A capital gain of the kind taxed in the years 1947-48 and 1948-49 may in any event be purely illusory in the sense that it may be subsequently lost. If that happens and losses are to be carried forward only, not backwards, or no gain equal in its amount accrues within the period of limitation the tax is in effect a surcharge on the tax imposed on ordinary kinds of income.

Question 49.—*Have you any comments on the present position regarding taxation of profits, which accrue or arise abroad, on their repatriation to India ?*

The total income of a person resident in the taxable territories includes

- (a) income accruing or arising abroad during the previous year ;

- (b) income which accrued or arose aboard between 1st April, 1933 and the commencement of the previous year which is brought into or received in the taxable territories during the previous year;

subject to the exclusion of Rs. 4,500 having accrued or arisen but not remitted.

The Act has recently been amended so as to exclude from total income remittances made out of income which accrued or arose abroad between 1st April, 1938 and the commencement of the previous year

- (a) unconditionally in his 1951-52 and subsequent assessments in the case of a person who was not resident in two out of three years immediately preceding the previous year;

- (b) with conditions in the case of a person resident not entitled to the benefits of (a).

For so long as incomes accruing or arising abroad attract the tax on both bases (i.e., accrual and remittance) and the assessee cannot be certain that his identification of remittance with the corresponding income will be accepted by the revenue or indeed the income will not be twice taxed there is a psychological impediment in the way of the remittance of foreign profits whether ordinarily or under the provisions intended to encourage it. India could with advantage adopt the U. K. basis of charge if capital is to be attracted; the emphasis is appropriately on the word 'capital'. Only remittances should attract the tax and then only limited to the foreign income; remittances subsequently made from funds derived from an income source which has ceased should be treated as capital.

Question 50.—What change, if any, is called for in the definition of 'dividend' (section 2 (6A)); e.g., in relation to 'bonus shares'?

Sub-clauses (c) and (d) of the definition constitute a negation of the axiom that saving is a virtue and of the principle that whatever is saved has become capital; it may be observed that it was not thought fit in the United Kingdom to deny that principle following appeal court decisions against the revenue on question concerning the character of a distribution of assets in a winding-up. The tax is a tax on income; any attempt to expand the plain or judicial meaning of the word is an offence against the fundamental canon of income taxation. The subject is to yield to the State only the fruit of the tree, not the tree itself.

The corporation tax is in reality a super-tax on profits saved or retained which are accordingly twice taxed by the definition's artificial device. At the very least there should be a spread-over of the charge to the tax. The period of six years prescribed at the proviso to sub-clause (c) could be appropriately adopted for that purpose.

This Chamber is strongly opposed to any proposal to extend the definition to include what is commonly known as an issue of bonus shares. By their issue nothing is added to the wealth of the shareholder; on the contrary the intrinsic value of each unit in his original holding has, by the act of converting the saved or retained profits, been reduced. And in any event these profits have already virtually borne super-tax.

Question 51.—Do the provisions of the Income-tax Act relating to the taxability of non-residents through their business connections in India in respect of income deemed to accrue or arise within the taxable territories (Sections 42 and 43 of the Income-tax Act) affect adversely the interests of persons engaged in foreign trade? If so, what modification would you suggest in these sections?

The question is concerned only with the trading activities of a non-resident, not with any investment he may have made in India.

Under Section 42 (1) income, profits or gains accruing or arising, whether directly or indirectly, through or from any business connection in the taxable territories are to be deemed to be income accruing or arising within the taxable territories. The section enlarges the scope of the statute; by an artificial device it brings within charge to the tax income which, according to normal concepts, would otherwise not be taxable. In most other countries the income of a non-resident from business is taxed only if a trade is exercised within the country so that profits in fact accrue from the trade so exercised.

The third sub-section to section 42 is designed to exempt from charge to the tax so much of the profits of the non-resident as are attributable to the operations of the business (in respect of which there is held to be a connection in the taxable territories) not carried out in the taxable territories. In case goods are manufactured abroad for export to India, the sub-section goes some way to restore parity with the taxing laws of other countries but only some way.

Under English law if contracts which entitle the person making them to receive profits are habitually made in the United Kingdom by or on behalf of a non-resident, he is so exercising a trade in the United Kingdom, even though the fulfilment of the contracts takes place wholly or in part abroad. On the other hand, if the contracts are made abroad, the mere fact that they have been secured through canvassing done or that help has been given in the negotiation and execution of the contracts by an agent resident in the United Kingdom does not by itself constitute the exercise of a trade. The English courts find unacceptable the argument that a trade is exercised in the country in a case where the non-resident habitually employs agents to obtain orders and transmit them abroad for execution.

The words 'business connection' have been acceptably defined to mean a continuity of relationship in a profit-making association. It is thought that in case that continuity of relationship exists between a non-resident and a resident to whom has been ceded the sole right to purchase for re-sale in India at his own risk the goods of the non-resident, the selling organisation of the resident can be held to exist for the purpose of selling the goods of the non-resident. As a consequence the act of the resident who canvasses the re-sale of the goods for his own account and risk may be held to be an operation of the business in respect of which there is held to be a connection between resident and non-resident, so long as there is an exclusive arrangement between the two persons, the third sub-section may not altogether exempt the profits of the non-resident from charge to the tax although all other operations including the making of the contract, the giving of delivery of the goods and the receipt of payment are carried out elsewhere than in the taxable territories.

The mere maintenance of a purchasing agency or branch in England does not constitute the exercise of a trade. It has been held in India, on the other hand, that where there is a regular agency established in India for the purchase of the raw materials required for manufacture and sale abroad there is a business connection in India and a portion of the profits of the non-resident attributable to the purchase of raw materials in India by the agent will attract the tax.

The fiction of India's section 42 is out of accord with the laws of other countries. It creates an artificial or notional basis for charge to the tax not easily understood elsewhere. It is not possible, however, to generalise in reply to the question as to whether or not the interests of persons engaged in foreign trade are adversely affected.

In the import field smaller traders have lost foreign business connections who preferred to abandon the trade rather than submit to assessment in India. In the case of more substantial business, non-residents usually submit to the process of assessment although not without exception and not always without surprise and resentment. The conclusion that prices are increased against India to cover the tax not relieved by the exporting country is inescapable. In its application to imports section 42 may be thought to be justified by revenue considerations but it would seem doubtful whether the net accretion, taking account of the increased cost of imports, can be substantial.

So far as concerns exports the Department of Economic Affairs of U. N. O. reported in 1950 that exemption from certain taxes is in most countries the norm for goods sold for export and cites examples of exemptions from taxes on manufacture, turnover, sales, luxuries and excise.

It cannot be assumed that the levy of income-tax, actual or potential, on a proportion of the foreign customer's profits operates so as to cause him to buy elsewhere or to reduce the price he is able or willing to pay. Much depends on other duties the traffic may have to bear and on alternative profit possibilities. There is no certainty that exemption from the tax would stimulate exports.

The objectionable feature of this particular legislation is the responsibility for payment of the tax put upon the person held as an agent under section 43. Only in exceptional cases is he able to recover the tax paid out of assets of the non-resident under the protection of the indemnity provided to him at section 65. His situation is frequently made the worse because the non-resident refuses to co-operate in securing a proper assessment and the agent is not able to bring the evidence necessary under section 2(6) for the grant of a declaration that the non-resident is a company. In the result, the total world income of the non-resident and his profit margin are estimated; the assessment is made at the rates applicable to an association of persons. In such cases the Department is not sympathetic and the estimates of total world income and of profit margin are not conservatively made. Interest chargeable under section 18A(8) is added although the person treated as an agent under section 43 may have had no warning

of his impending responsibility at 15th March of the previous year and he is in any event in no position to file an estimate of the non-resident's profits for compliance with section 18A(3).

In such cases there is real hardship and adversity to the persons engaged in foreign trade to the extent that the carrying on of their business is attended by constant apprehension. There are no means by which the business may be arranged so as to keep the non-resident entirely out of charge to the tax. If the provisions of sections 42 and 43 are invoked will the non-resident co-operate in discharging his liability under what he regards as an unusual and unjust tax law?

The revenue would undoubtedly suffer if the Indian trader were relieved of his responsibility for payment of the tax. Any sanction imposed, in the alternative, upon the traffic between the resident and non-resident would be still more unpopular and would not perhaps be practicable upon a relaxation of existing controls.

Under English law, not only must the trade be exercised in that country; there must also be a person chargeable to the tax. The parties are able to arrange the course of conduct of the business, e.g., as between principals, so as to keep the non-resident out of the charge. As may be seen from the case law on the subject, however, not all of England's foreign trade avoids the tax. Nor would all of India's foreign trade if the English law were adopted. That appears to be the only possible remedy.

The second sub-section of section 42 requires no amendment. The substance of that sub-section is embodied at section 37 of the English Act of 1951.

In the alternative to adopting the U. K. law, sections 42 and 43 may be amended so as to define a business connection in the language of the United Nation's Model Convention for the Avoidance of Double Taxation according to which a non-resident person shall not be deemed to have a business connection in the taxable territories unless he maintains therein a branch, management, factory, or other fixed place of business. An agent in the taxable territories for a non-resident person shall not be deemed to be a business connection unless he has and habitually exercises a general authority to negotiate and conclude contracts on behalf of the non-resident of keeps a stock of merchandise from which he regularly fills orders on his behalf. A non-resident person shall not be deemed to have a business connection in the taxable territories merely because he conducts business dealings through a *bona-fide* broker or general commission agent acting in the ordinary course of this business as such. A fixed place of business or an agency maintained by a non-resident person solely for the purchase of goods within and conversion or sale without the taxable territories shall not be deemed to be a business connection.

Question 52.—What modification would you suggest in the definition of "agricultural income" (section 2 (1) to avoid the contingency of the same income being taxed by the Central Government as well as the State Governments, e.g., in respect of income from forests, dividends from agricultural companies, etc.?

It is the opinion of this Chamber that the scope of the Income-tax Act should be extended to incomes from agriculture and the requisite amendment of the Constitution and of the Act be undertaken accordingly. That being so, the Chamber submits no other reply to this question.

Question 53.—Are you in favour of integrating agricultural income with non-agricultural income for rate purposes? If so, which of the following methods would you advocate:

- (i) Aggregation of agricultural and non-agricultural incomes only under the State Acts;
- (ii) Aggregation of agricultural and non-agricultural incomes only under the Central Act;
- (iii) Aggregation of agricultural and non-agricultural incomes both under the State and the Central Acts?

Please discuss the administrative, constitutional and other problems that are likely to arise if any of the above alternatives is adopted.

The question of integration for rate purposes arises only so long as agricultural incomes as defined at section 2(1) continues to be exempt from the tax. In the alternative to extension of the scope of the Act so as to bring agricultural income within its charge, no variant of the methods of aggregation postulated is logical. Any one of them must otherwise result in the virtual imposition of an additional tax on the agricultural income of the subject who has non-agricultural income also and must accordingly operate to the advantage of the subject whose only income is from agricul-

ture. In the opinion of this Chamber nothing short of extension of the scope of the Act to incomes from agriculture can result in an equitable distribution of the tax burden.

Question 54.—Would you recommend the abolition, by a suitable amendment of the Constitution, of the distinction between agricultural and non-agricultural incomes and the taxation of both types of income, aggregately under a Central Act.

The Todhunter Committee of 1924-25 closely examined this question and concluded that there was no historical or theoretical justification for the continued exemption from the income-tax of incomes derived from agriculture. There were, however, administrative and political objections to change at that time. Dr. R. P. Paranjpye by his separate minute expressed the view that it was not possible to delay indefinitely the consideration of the vested interests created by the permanent settlement of Bengal and the consequent exemption of considerable incomes from taxation. The Hon'ble Sardar Jogendra Singh was of opinion that, if the burden (of taxation) were to be equally distributed the land tax must come under the Income-tax Act. The fusion would take time.

The administrative difficulties referred to by the Todhunter Committee are not 28 years later apparently of such significance as to deter certain States from the exercise of their rights under the Constitution. Nor apparently has it been found that the political objections are insuperable and it may be observed, in passing, that the constitutional right has been exercised in parts of India where objection to it was likely to be most vocal.

A tax offends against the canon of equality if its burden is not shared by all in proportion to the income enjoyed by each under the protection of the State. A tax on income should be a tax on every income. This Chamber accordingly recommends the abolition of the distinction between agricultural and non-agricultural incomes and the taxation of both types of income aggregately under the act.

Question 55.—Is the treatment given to irregular and fluctuating income in the present law satisfactory? In particular, should any changes be introduced—

- (i) to average income over a number of years where receipts are irregular and fluctuating;
- (ii) to spread lump sum receipts over a number of years?

The special provisions recently made for royalties or copyright fees go as far as meantime appears necessary for the relief of income of the kind.

By a recent amendment of the Act death-cum-retirement gratuities paid by Central Government or a State Government are entirely exempted from charge to the tax. It is thought that is not a new exemption but the amendment merely gives statutory effect to an exemption always enjoyed by certain civil servants sanctioned only by undisclosed convention. Gratuities paid to the employees of private enterprise attract the tax as they should; their exemption also not correct the position. It is, however, suggested that the spread-over relief for such gratuities usually granted under section 60(2) should likewise be given statutory effect and they be taxed by the inclusion in total income over a period of eight years by equal instalments.

Question 56.—Do you think the present provisions regarding exemption of charitable and religious trusts need any modifications?

The Chamber makes no reply to this question.

Question 57.—(i) Should the business profits of co-operative enterprises, which are now exempt, be charged to income-tax and super-tax? If so, should co-operative societies be treated as companies or should a lighter levy be imposed? In case the exemption is continued, should it be restricted to certain categories of co-operative enterprises?

(ii) Do you agree with the view that the income derived by co-operative housing societies by way of rent should not be treated as income from property assessable to income-tax? Would you, in this respect, differentiate between tenant co-partnership housing societies and other types of housing societies?

(iii) It has been suggested that there are divergent decisions by different income-tax authorities in respect of assessment of income of co-operative societies from sources other than business. If this is so, please indicate such decisions and the measures you would suggest to secure uniformity in assessment.

No consideration of the advantages accruing from the institution of co-operative principles or of the admitted merits of co-operative societies is necessary nor indeed does the question require such a consideration. The

Central Government and at least the Bombay and Madras State Governments have legislation in force designed to facilitate the formation of co-operative societies. These co-operative societies are intended to promote thrift and self-help among agriculturists, artisans and persons of limited means with common economic needs and so to create better living, better business and better methods of production. It must, presumably, be left to the Executive to see that proper use is made of the various co-operative Societies Acts. In Bombay, for example it is pre-requisite to registration of a co-operative society that it is formed for the object of promoting the economic interests of its members in accordance with its co-operative principles. The expression "co-operative principles" is not defined; it is the duty of the Registrar to be satisfied that the pre-requisite is present.

Co-operation as represented by the co-operative society differs basically from capitalism as represented by the joint stock company inasmuch as while co-operation recognises that capital is entitled to a fair interest it refuses to admit any other right attaching to its possession, more particularly a claim to a controlling voice in the enterprise. It is essentially a type of organisation for those with common economic needs and it may well be said that (again assuming there is proper executive control over the formation of and administration and membership of co-operative societies) it would defeat the very objects of co-operation to levy taxes upon the societies. On the other hand, it can be argued that there is no need and that it is not desirable to give co-operative enterprises as full an exemption as they now enjoy.

By a Notification issued in 1925, the profits of any co-operative society, other than the Sanikatta Salt Owners Society in the Bombay Presidency, for the time being registered under the Co-operative Societies Act 1912, The Bombay Co-operative Societies Act, 1925 or The Madras Co-operative Societies Act, 1932, or the dividends or other payments received by a member of any such society out of such profits are exempt from both income-tax and Super-tax but are to be included in the total income of the member. By an explanation to the Notification it is provided that the exemption does not extend to (a) income from securities taxable under Section 8, (b) income from property taxable under Section 9, (c) dividends or (d) income taxable under Section 12 as income from other sources.

The Present principles of income-tax made applicable to mutual concerns would apply to co-operative societies (even if no specific exemption were given) and a co-operative society would be exempt from tax on its so called profits in proper circumstances. Trading profits would not, however, be exempt.

The exemption given by Government to dividends or other payments received by a member of any such society out of its profits does not appear truly to derive from the principles of co-operation and might be withdrawn but presumably the loss of revenue, having regard to the income of the type of person concerned, is extremely small.

There is no reason why business profits of co-operative enterprises should continue to be exempt from income-tax and super-tax except in so far as they would in any event be exempt having regard to the principles applicable to mutual associations. As regards the rate of tax, they should be treated on the same footing as companies, because, having regard to the source, there is no reason for any distinction. In case the exemption is continued it should be restricted to categories of co-operative enterprises which are quite clearly associations of poor persons formed for their common economic good.

There is no reason why there should be any exemption from charge to the tax under section 9 of the Act in the case of co-operative housing societies. There is no exemption now and, while it may be an excellent thing that persons who are perhaps unable to build individual dwelling places should associate themselves for the purposes of building and maintaining dwelling houses more economically, there is no reason why they should not pay income-tax on the annual value of such property in the normal way. There is no ground for any differentiation between tenant co-partnership, housing societies and other types.

It is not known what are the divergent decisions in respect of the assessment of the income of co-operative societies from sources other than business referred to but, even with the present exemption, the question of applying the general principles governing mutual concerns to co-operative societies still arises in the case of co-operative societies registered abroad, or for the purposes of deciding whether the surplus accruing to a co-operative society is to be included in its total income to determine the rate of tax applicable to its total income; in the case of *The English & Scottish Joint Co-operative Wholesale Society Ltd. Vs. The Commissioner of Income-tax, Assam*, the Privy Council laid down certain prin-

ciples applicable to the taxation of mutual concerns which definitely differ from propositions previously laid down by certain Indian High Courts, e.g. *The English & Scottish Joint Co-operative Wholesale Society Ltd. Vs. Madras Income-tax Commissioner* (3 I. T. C. page 385).

Question 58.—Are you in favour of continuing the concessions given to new industrial undertakings under section 15C of the Income-tax Act? Have initial and extra depreciation allowances made the concessions practically infructuous? If so, what are the directions in which the provisions of this section should be modified?

These criticisms lie against section 15C and these remedies suggested:—

- if it is designed to increase production the concession should extend to existing undertakings as does section 56A; that may be done at little cost to the revenue since new production will usually be subsidised by old; the difficulty of application is not insuperable;
- the concession may be rendered infructuous by the initial and additional depreciation allowances which are not in themselves a concession but they are virtually interest-free loans; the undertaking should have the option to postpone the claim to these allowances at least until the expiration of the five year period; in the alternative the grant of the concession may run from the year in which assessable income first appears;
- the revenue is committed to the principle that the exemptions in each year should extend in the aggregate to 30 per cent. of the capital; there is no certainty of benefit within the five year period whether that runs from the commencement of manufacture or from the beginning of the year in which an assessable income first appears and so the limitation may be removed, restricting the concession to 6 per cent. in each year subject to a maximum of 30 per cent.

Question 59.—A suggestion has been made that banking profits of foreign branches of Indian banks should be given concessional treatment for tax purposes in order to encourage the opening of branches abroad. What are your views?

All business not only that of banking, should be encouraged to extend the scope of its operations to foreign countries. A special case may be made for banking on the grounds that it cannot easily compete with institutions already established abroad but the same may be said of insurance or, indeed, any other business. Exports of goods and services would be stimulated if the foreign profits of business resident in the taxable territories were taxed at lower rates but the concession must necessarily apply only to profits brought in. The possibilities of a shift of capital and a diversion of profits are obvious. Checks would necessarily be employed.

Question 60.—Should any liberalisation be made in the present limits of exemption from tax of life insurance premia and contributions to provident funds?

Although the general price level and consequently wages have multiplied in the meantime the exemption limit has in the individual case remained static at one-sixth of total income subject to a maximum of Rs. 6,000 since 1939. The value of the abatement, which is for income-tax only, was actually reduced in 1950 when there was a reduction in income-tax rates, slightly offset in 1951 and subsequent years when the 5 per cent. surcharge was imposed; and it may be noted that earners in the upper-income brackets were doubly penalised in 1950 when the revenue loss of income-tax was recouped by a corresponding increase in the super-tax rate.

All of the arguments favouring a substantial increase in the abatement are so widely known as not to require repetition. Attention is, however, directed to the findings of the recent U. K. inquiry into the quantum and effect of the investment of insurance companies' funds. Insurance companies are the largest investors in Government loans and in addition invest a substantial part of their funds in private enterprise which they do not seek to control. The State enjoins on the subject the need to save but Pellon in the shape of higher rates of taxation coupled with reduced reliefs is piled on the Ossa of higher living costs; there is no margin for saving and indeed the incentive to work and to save is destroyed. There is no better form of saving than that which is canalised to State loans and private enterprise through insurance companies and provident funds; that, once embarked upon, it acquires an element of compulsion makes it better still. This is a wrong to be righted as quickly as possible. There must be a substantial degree of liberalisation.

Question 61.—(i) Do you favour the grant of larger depreciation allowances to assist industry to finance the considerably increased costs of replacement of assets? If so, how and in what form should they be given—

- (a) by larger depreciation allowances on new assets;
- (b) by revalorisation of existing assets;
- (c) by treating the excess of replacement cost over original cost as revenue expenditure;
- (d) by any other method?

(ii) What is the justification for assistance from public resources to certain classes of tax-payers only by way of covering partially the excess of replacement cost over original cost of old assets?

(iii) In case adequate justification exists for assistance by Government in the form of tax concessions to meet the situation, what safeguards should be prescribed to see that the funds so made available are utilised for the purposes for which they are intended.

Although most of the damage caused by inflation has been done and cannot easily be undone, there is still a strong case for increased depreciation allowances.

The cost of buildings, plant and machinery during the eight or nine years preceding 1939 were relatively stable. During the war costs increased steadily but there were price controls and in any case new buildings, plant and machinery were not readily acquired. After 1945 costs increased very steeply until well into 1952. A pre-1939 cost index of 100 increased in 1945 to 175 and in 1953 to over 300. In the result, industry which has depreciated fixed assets on the basis of pre-war cost and based the prices of its products accordingly, has dissipated assets and lost capital.

Prudent industry has included in costings a depreciation charge based on the replacement cost of assets and has built up depreciation reserves. That, however, is not sufficient; a further provision must be made to cover the excess of the cost of replacement over original cost so that, in addition to a depreciation provision equal to the full book value of the assets, there is a further reserve for replacement.

That procedure, provided profits permit, would set aside the finance necessary for replacement in due course if it were not that taxation confiscates about half the provision made in excess of the standard income-tax wear and tear allowances which are based rigidly on original cost and diminish progressively being calculated on written-down values. In that condition, in order to provide fully for the replacement at present day prices of an asset purchased in 1939, industry must reserve or write off six times the normal depreciation. One half is taken by tax leaving as net provision three times the original cost to cover the inflation factor and provide a reserve for future replacement. Not all industry is in a position to provide out of profits depreciation and fixed assets replacement reserves at six times original cost; as a result capital has been dissipated over the years since 1939.

Most of the damage has been done and it would not now be financially possible, even if the principle were accepted, for the revenue to make good the excess tax collected. The finance necessary for replacement has to be found from other sources (additional capital from share-holders or the public or bank borrowing) in cases where adequate reserves have not been made in the past. The position could even now be remedied to an extent if there were depreciation allowances based on the replacement cost of assets. That would best be done by means of a revaluation but the difficulties of such a procedure, coupled with the possibilities of dishonest practices, would make detailed revaluations impracticable. In any case, the records of many concerns would not provide sufficient data. It should, however, be possible to base a relatively simple formula on the assessment record. Thus:—

- (1) the value of assets purchased up to 31st December 1940, as shown by the income-tax returns, should be trebled;
- (2) the value of assets purchased between 1940 and 1945 should be doubled;
- (3) the value of assets purchased between 1946 and 1949 should be increased by 50 per cent.

From the aggregate so ascertained should be deducted the total depreciation allowed in taxation assessments to date and a revised written-down value derived, on which to allow future depreciation.

In the alternative the existing written-down values could be increased by the same factors instead of applying them to original cost.

Any allowance by itself, in whatever form, does not entirely meet the case. Capital has already been dissipated by a combination of inflation and confiscatory tax. The problem now is to find the finance for the replacement of assets. Initial allowances, although in

effect only interest-free loans, taken in conjunction with a revaluation on the lines indicated would be a great help. The finance must be found. But that would derive from the reliefs arising out of the initial allowances following the replacement of the assets. To this end, the initial allowances should be as high as revenue can afford. Even an initial allowance of 100 per cent. (i.e., treating the replacement costs as revenue expenditure) would not be out of the way considering the present difficulties of certain industries.

The treatment as revenue expenditure of the excess of replacement over original cost would probably be impracticable; in view of technical developments it is very unlikely that an asset purchased 20 years ago would be replaced by an exactly similar asset.

The justification for assistance from public resources lies in the damage that has been done to the industrial structure by the combination of inflation and taxation of profits necessarily reserved. Plant wears out and has to be replaced; even buildings in time have to be replaced, although admittedly there is less justification for particular consideration in the case of buildings. Other classes of taxpayers are not in the same case at all. Even though there may have been a time lag, the effects of inflation in the case of other taxpayers have been off-set by larger emoluments.

Any form of concession introduced may be conditioned by requiring its investment or deposit with a scheduled bank pending its reinvestment for the purpose for which it is intended.

Question 62.—Are any changes called for in the classification of assets for purposes of depreciation, rates of depreciation and methods of computing the allowances?

No change appears to be called for in the classification of assets for the purposes of the allowance for depreciation. It is the general consensus of opinion that the rates are too low for application to the written-down value. Slightly lower rates applied to original cost would be preferred. The objection to the basis of original cost on account of the difficulty of annual identification of the asset is not entirely valid. When the asset is sold or scrapped the year of its being brought into use is to be determined for the purpose of computing the balancing charge. Attention is however directed to the difficulties of the electricity supply industry by reason of the different statutory rates of depreciation prescribed under the Income-Tax Act and under the Electricity (Supply) Act, 1948.

Question 63.—Should any tax concessions be given to encourage development of mineral resources? If so, what form should they take? In particular, should depletion allowance on wasting assets be allowed? How should it be computed for different kinds of assets you have in view?

The Acts provisions relating to the taxation of income from mining are in accord with the principle that the cost of raw material for conversion by a manufacturing process is a revenue expenditure but the cost of the mining site or the right to mine is an expenditure of capital just as much as the cost of machinery or buildings.

The provisions of section 56A may reasonably be extended to any enterprise engaged in the development of mineral resources. In addition there should be provision for allowance of the amortization of the cost of mining rights and other expenditure of a capital or quasi-capital nature not entitled to any allowance for depreciation.

Question 64.—In what form would you provide for personal and family allowances—

- (i) exempting the first slice of income from tax; or
- (ii) providing specific allowances for family and dependents? In the case of (i), do you consider that the first slice—Rs. 1-1,500—should be revised? In the case of (ii), what treatment would you give to the Hindu undivided family?

The present individual exemption limit of Rs. 4,200 is excessive, judged only by India's general standard of living. Judged otherwise, as by political considerations or difficulties of assessment and collection, it may be expedient. However that may be the need for personal and family allowances is adequately taken care of by the absence of charge on the first Rs. 1,500 and by the imposition of less than the standard rate of tax on incomes not exceeding Rs. 15,000 in a country where marriage is almost universal and large families the rule rather than the exception.

Question 65.—Should the present law regarding admissible expenses (section 10(2)) be altered? If so, please indicate, with reasons, the items of expenses

- (i) which are not now admissible but, in your view, should be admissible and
- (ii) which are now admissible but, in your view, should not be admissible.

The expenses to be admitted in computing the profits of a business, profession or vocation are specified at clauses (i) to (xv) of the second sub-section. After providing for certain expenses which by their special character require separate specification, general provision is made for any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of the business, profession or vocation. It has not been found necessary, practicable or expedient to attempt a specification of all the kinds of expenditure to be allowed and indeed, if that were attempted, there would be no end to discovering that something had been omitted.

In general, there are two kinds of expenditure, capital and revenue. Capital expenditure is to be disallowed but, whereas the section provides for the annual allowance of the loss in the value of buildings, plant, machinery or furniture by depreciation and all expenditure truly of a revenue character is to be allowed there is another kind of expenditure for which, by reason of its quasi-capital character, there is no allowance either upon its being laid out or over the period of years to which the expenditure may be related. There is an exception to that general rule. Specific provision is made for the allowance of expenditure incurred on research even if that expenditure is of a capital nature.

The post-war establishment and development of a number of industrial units has been made possible by association with industry in other countries. The foreign industrial unit has been established for many years and is possessed of all of the technical knowledge which the industrial unit in India is to acquire, alternative to its ready-made purchase, only by much expenditure on research and costly experiment or by the employment of foreign technicians. A number of such units have accordingly contracted with foreign industry for the grant of a licence to manufacture and the provision of technical assistance. The consideration paid for that licence and that assistance is described by the revenue as an expenditure for enduring benefit, a description having no legal sanction. In the event, the expenditure is disallowed although so much as was estimated to be attributable to the cost of the continuing technical assistance has been allowed in appeal in one case and the department has not contested the decision of the appellate authority.

The licence to manufacture is granted for a limited period of years, which may be as short as five, after which it may be revoked. Its cost is just as much an expenditure laid out or expended wholly and exclusively for the purpose of the business as is the cost of research. At the least it is entitled to the same treatment. Because of its quasi-capital character, being a fixed sum paid in cash or by a free allotment of shares, its allowance is inadmissible under clause (xv) of section 10(2). The Legislature have thought fit to make specific provision for the allowance of expenditure of a capital nature on scientific research; the like provision should be made for the cost of a licence to manufacture with which is combined technical assistance related, however, to the term of the contract under which it is paid.

There are other kinds of expenditure of a quasi-capital nature for which specific provision should be made including the cost of mining rights to which reference is elsewhere made and a premium paid for the lease of land or of buildings.

In a reference made under section 66, the High Court may make an order as to costs. The Income-Tax Appellate Tribunal has no such discretion nor has the Appellate Assistant Commissioner. On the other hand the costs incurred by the assessee in taking an appeal are not admissible as an expenditure. The revenue point of view that the Department bears its own costs is irrelevant; the tax-payer provides the revenue and so in effect bears the costs on both sides. Provision should be made for the allowance of the assessee's costs in the same ratio as his success in appeal.

In a state of inflation and increased taxation there is little or no individual saving. As consequence the practice of rewarding the services of executives by the provision of a retirement benefit has become almost universal. The executive may be a member of his corporation-employer in which case the retirement benefit serves to augment savings made through profit retention. The cost is an admissible deduction from profits for the purpose of income-tax assessment usually under the sanction of section 58R. In case the whole cost is borne by the employer, there is no conflict with the provisions of section 15 by which the exemption of provident fund contributions and life insurance premiums is restricted.

Individuals or partners in firms who are members of professional bodies engaged in the practice of a profession are denied the advantages of incorporation and of saving through profit retention. They suffer the double disability that, not being employees, as are the executives of a corporation, the cost of provision of a retirement benefit is not an admissible deduction in

income-tax assessment. Nor can they realise the value of goodwill acquired by purchase or created by hard work since high prices and high taxation leave no savings in the hands of their successors to pay for it. In the result persons with professional qualifications now prefer employment in business or industry; in the next generation only those temperamentally unsuited to business or industry or who have inherited means or for whom the work is a vocation rather than a profession will be found in the practice of the professions. That is already the position in England and in the U. S. A.

Any logical basis for the distinction no longer exists in a condition in which the professional man's remuneration, after deducting his expenses and taxation, is only a living wage; but the distinction subsists only because he is a casual worker not in the service of any one employer. That is no warrant for its continuing. Provision should be made in the assessment of incomes from the professional for the deduction of the cost of providing retirement benefits. The savings in a private company through profit retention may extend to some 22½ per cent. of income. The allowance for which provision should be made may extend to one-third of the income so as to include also the cost of contributions to an approved superannuation scheme.

The section calls for no amendment so far as concerns expenses which should not be allowed.

Question 66.—(a) Are you in favour of combining income-tax and super-tax into a consolidated levy?

(b) What are the merits or demerits of such a step from the point of view of (i) assessee (ii) administration?

(c) Are you satisfied with the degree of progression in the present rate structure (both income-tax and super-tax) especially in regard to its economic effects?

(d) In case you consider a change is necessary, what alternative rate structure would you recommend?

(e) Should the rate of surcharge levied under Article 271 of the constitution also be graduated?

The questionnaire has elsewhere invariably referred to the super-tax on companies as the corporation tax. It is assumed that this reference is made to the super-tax on personal incomes only since also the corporation tax is not shared with the States and accordingly must continue to be a separate levy.

There appears to be no great objection to a consolidation of the two taxes and in fact their combination is desirable if those reliefs presently granted in respect of the income-tax only were then to abate the consolidated tax. The consolidation would in a number of ways reduce clerical work in the administration without reducing essential statistical data.

The degree of progression in the super-tax scale is too steep. At the lower end of the scale no savings are left to a large class accustomed to save and to invest in government loans and industry. At the other end, the microscopic net return does not warrant putting the capital at risk. At the same time the super-tax exemption limit may be too high in a poor country. Those in the range of Rs. 20,000 to Rs. 25,000 receive the full benefit of the allowance for earned income and are perhaps in a relative sense least taxed as a consequence.

No criticism lies against the degree of progression in income-tax rates which, combined with the exemption limit, takes care of those factors for which no specific allowance is made. If, however, the expenditure of the State is to be financed not entirely by taxation but also through savings and if conditions in which industry may look to public subscription to provide funds for its expansion are to be re-created, there must be a less rapid progression in the super-tax incidence. In the suggested scale the first Rs. 20,000 would be exempt, the next Rs. 5,000 would bear half an anna, the next Rs. 5,000 one anna, the next Rs. 10,000 one and a half annas, the next Rs. 10,000 two annas; each subsequent Rs. 10,000 up to Rs. 1,00,000 would arise by one anna to seven annas and the balance charged at eight annas.

It is hoped the surcharge is not a permanent institution. It need not be graduated but its incidence should be equal in the same proportion as the tax.

Question 67.—Have you any change to suggest in the exemption limit for individuals (Rs. 4,200) and for Hindu undivided families (Rs. 8,400)?

The present exemption limits are generous if not, indeed excessive. While it is desirable that every subject should contribute according to his means and so made conscious of his responsibility to the State (an end to be achieved by a lowering of the limit combined with levy of a reduced rate of tax on the income brought within charge), that may be inexpedient by reason of the difficulty of assessment and collection.

Question 68.—(a) Are you in favour of a distinction being made between earned and unearned incomes? What is the economic justification for such a distinction?

(b) Is the present definition of "earned income" in section 2(6AA) of the Income-tax Act adequate in this respect or would you suggest any modification?

(c) Should the quantum of relief now afforded be extended or reduced? If so, to what extent?

This Chamber approves the distinction between earned and unearned incomes, economically justified since it is an incentive to work which is the basis of all productivity and it affords a measure of recognition of the principle that there must be an allowance for the depreciation of the capital assets of the earner, i.e., his physical and mental capacity to work as well as for expenses of a personal character including transport, for which there is no other allowance. If the need for a distinction is admitted it must logically extend throughout the entire range of incomes and abate the super-tax also; otherwise it is not what it purports to be but is merely a relief given to smaller incomes. It is observed in passing that the earned income allowance has now been increased in the U. K.

The definition of earned income at section 2(6AA) is considered adequate.

Question 69.—Have you any changes to suggest regarding the principles followed in valuing stocks of a business for assessment purposes?

The stocks of a business are to be valued for assessment purposes at either cost or market value whichever is the lower. Subsidiary thereto the principle may be applied unit-wise in the preparation of the stock inventory. It is thought that if profits are to be correctly determined the same mode of valuation must be employed at the end of each accounting period and accordingly there is no sanction for any variation in practice in making a determination of what is cost. There are three variants of that practice:

- (a) the average cost of accounting period may be taken;
- (b) it may be assumed that the materials or articles remaining in stock are those most recently purchased; or
- (c) it may be assumed that the materials or articles remaining in stock are those purchased at the outset of the accounting period.

Prices are now relatively stable; a consideration of the question is perhaps now of more academic than real significance. It was not, however, academic in the period of inflation which set in in 1938. Prices gradually increased until 1945 and increased thereafter with greater impetus, aggravated by the outbreak of war in Korea. If, however, there is now to be a recession in prices as a consequence of more settled world political conditions the question may again become of very real concern to all business.

If, when prices are rising, the stock inventory is not valued according to the principle that the materials or articles most recently purchased are deemed to have been first consumed or sold the profit & loss account will not, it is thought, disclose the true profit of the business. The converse applies equally when prices are falling.

If the original capital is to remain intact the profit inclusion in the selling price must be doubled to take care of the false profit factor; the inflationary condition is accordingly given added impetus. Reserves may admittedly be made although without allowance of any income-tax deduction but, the higher the tax, the greater the difficulty of preserving the capital intact.

It is thought that the principle of valuing stocks at cost or market value whichever is the lower should equitably be rendered less inflexible so as to permit a valuation by reference either to average cost or the cost of materials or articles most recently purchased or the cost of materials or articles earlier purchased, giving the assessee the option in each year to employ any of these variants.

Question 70.—Do you consider that any change is called for in the method of assessment of the Hindu undivided family? If so, in what respects?

The Chamber makes no reply to this question.

Question 71.—Should exemption from income-tax be allowed in respect of voluntary surrender by managing agents of the whole or a part of managing agency commission? What safeguards should be laid down against misuse of such a provision?

The question is so phrased as to suggest that the commission of a managing agent voluntarily waived or surrendered is presently included in the managing agent's assessable income and asks what safeguards should condition its exclusion if provision is so made. The implications, however, seem clear. The commission of the managing agent is frequently voluntarily waived or surrendered. In the majority of cases that is done for good consideration as when the company is in its infancy or conservation of its resources is necessary for its survival. There may be other cases where there has

been waiver or surrender and the good consideration referred to was not present; the managing agent thereby avoids both income and super-tax and gains by the tax-free increment to the value of his holding in the managed company.

As to whether the commission of a managing agent, voluntarily waived or surrendered in whatever circumstances, attracts the tax is a question to be resolved by reference to the facts and perhaps not without difficulty. The element of receivability must be present and the method of accounting employed by the managing agent may be significant. However that may be, no objection may reasonably be taken if the definition of 'income' at section 2(6C) is expanded to include or the Act is otherwise amended to bring within charge to the tax the commission of a managing agent voluntarily waived or surrendered only to avoid or reduce his own liability to the tax.

Question 72.—On what basis would you suggest that double income-tax avoidance agreements should be concluded between India and other countries?

in the absence of any convention with another country income which accrues or arises abroad is presently entitled to a unilateral relief. That relief does not extend to income which accrues or arises abroad but is deemed to accrue or arise in India brought into charge to the tax by artificial device of section 42(1). So far as concerns this second class of income a non-resident may get no relief in his own country for the tax paid in India; the aggregate tax incidence may consequently exceed the income.

Even at the cost of some immediate sacrifice of revenue, it is desirable in the long-term interest of India's trade and international relations and as well to create a better climate for the attraction or foreign capital that double income-tax avoidance agreements be concluded with other countries. Such agreements should be in the form of United Nations Model Convention for the Avoidance of Double Taxation adopted by members of the Commonwealth, the U. S. A. and a number of European countries.

Question 73.—Is the present law relating to determination of "bonâ fide annual value" of property and deductions allowed from it satisfactory? If not, please give any alternative proposals you have in this respect.

Section 9 charges income from property not occupied by the subject for the purposes of any business, profession or vocation carried on by him the profits of which are assessable to income-tax. The income is to be notionally determined as the bonâ fide annual value with deducted therefrom certain allowances for repairs, insurance, interest or other annual charge, land revenue, costs of collection and vacancies.

The annual value is to be deemed to be the sum for which the property might reasonably be expected to be let on rent, reduced in case the property is let, by the tenant's liability to taxes levied by any local authority borne by the owner notionally determined.

It may be correct to hold, as did the Investigation Commission, (paras. 336/9), that there can be no allowance for the depreciation of property not occupied for business but it is surely illogical to apply municipal taxes as a deduction in a determination of the annual value having the effect of reducing the allowance for repairs, vacancies and possibly collection charges. Nor is it logical to fix the deduction for municipal taxes at one-half of such taxes or one-eighth of the annual value whichever is the less regardless of the liability of owner and tenant respectively for their payment.

The prescribed allowances should include the municipal taxes payable by the owner.

Question 74.—Is any change required in respect of provisions relating to carry-forward of losses? Are you in favour of allowing losses to be carried backward in case of cessation of business?

The period of years over which losses may presently be carried forward is approximately related to the periodicity of the advance and recession of the trade cycle. In theory at least, however, the six year period is inadequate; the profits earned at the outset of the cycle's advance may not cover the losses suffered in the first years of the recession. By ordinary standards, however, business cannot survive such a condition and it may be of no practical consequence that losses cannot be carried forward indefinitely.

A loss is to be set off against income under any other head in the same year and to the extent it is not so set off, it is to be carried forward. In a subsequent year, however, it is to be set off only against profits in the same business. That is objectionable. There seems to be no logical reason why, if a loss in business can be set off against income from investments or from another business in the year in which the loss is suffered, there should be a denial of the principle so far as concerns the excess of the loss over income under another head. Typical of much business is the company engaged in

industry and having part of its capital or reserves invested. The income from investments is taxed as income from securities or from other sources. The excess of the loss in business over that other income in the year in which the loss is suffered is not, failing the facility for a set-off against income from business, to be set off against the income from securities or other sources in the subsequent year. That position arises also in the case of life insurance business whose liabilities in its formative years usually exceed the fund and there is a deficit. The income from securities required to be held under section 27 of the Insurance Act of 1938 to cover the shortfall between the assets of the fund and liabilities is not income from the business of life insurance but is income from securities. The loss of the inter-valuation period is not to be set off against the income from investments in the subsequent year.

Income tax is a tax on the person not on business as was the excess profits tax. It is the net income of the person which is to be taxed. The restriction on the carry forward and set off of a loss is an offence against the fundamental principles of the taxation of incomes and is entirely unwarranted.

The tax laws of the U. S. A. include provision for a carry-back of loss. There is a general desire for such a provision in India also but it is thought that the time for giving expression to that desire is not now opportune. The success of India's Five-Year Plan and the hopes business may entertain for a taxation relief in this particular form are closely co-related. In case there should be a trade recession the absence of revenue will prejudice the success of the Plan. It would be most unrealistic to contemplate the further embarrassment of the State in case tax collected in preceding years were to be repaid.

There is, however, a case for a carry-back of loss if a business is discontinued. The surplus distributed by a liquidator in a winding-up attracts the tax through the definition of a dividend if it derives from the profits of the preceding six years. In case losses have been suffered during the like period resulting in a loss of capital there is hardship if these losses are not carried back at least to the extent of the capital lost. The surplus in a winding-up is not income excepting by the definition's artificial device. It is part of the proprietors' capital. If the appropriation of that capital to the State revenue is at all warranted, to the same extent is a repayment of the tax paid during the like period so far as that is related to the capital lost.

Question 75.—Do the provisions relating to the payment of advance tax under section 18A of the Income-tax Act need any modification?

There is need for amendment of sub-section (2). It is open to an assessee to lodge an estimate and to pay the tax by equal instalments on such of the prescribed due dates as have not expired. The department has already by executive instruction extended the date for lodging an estimate to enable that to be done even some days after a due date and for paying the instalment due according to the estimate although the due date has passed. That relief was found necessary in case a demand made under sub-section (1) was served on or so close to the due date as to give the assessee no reasonable time within which to exercise his right under sub-section (2); the relief may be imported into the Act by giving the assessee fifteen days from service of the notice of demand within which to file an estimate under sub-section (2) and the like extension of time for payment of the instalment.

Sub-section (6) has recently been amended to give the executive power to reduce or waive the interest payable by an assessee in such circumstances and in such cases as may be prescribed. The intention remains undisclosed since there is apparently as yet no notification on the point. If at all there is need to relieve cases falling under sub-section (6) there is clearer need still to relieve certain which fall under sub-section (8).

In case a person resident is treated under section 43 as the agent of a non-resident he is caught by the section's machinery although the section 43 notice was not first served on or before 15th March of the previous year of assessment. If for example a section 43 notice is served for the first time on 31st March, 1953 the right to file an estimate of the income of the non-resident may have already prescribed at 15th March 1951. Although there may have been no reasonable grounds for apprehending action under section 43 nor any certainty as to its outcome if such action were taken, the person held as an agent is rendered liable for interest from 1st April, 1952 and to penalties under section 28 in respect of any tax found payable in 1951-52 and 1952-53. Not only is the onus of discovering new section 42(1) assessee thereby in effect transferred to the subject but the Statute is in this respect so utterly unrealistic as to assume that a section 43 agent is able to estimate the income if a non-resident or that the non-resident will co-operate in the preparation of an estimate in advance of the institution of any proceed-

ings under section 43. It is apparently the view of the department that the estimate may be accurately made even without the non-resident's assistance. Any attempt at such an estimate must be pure speculation.

The section must be amended so as entirely to exclude assessments made under sections 43 and 42(1) and as well to make the power of substitution provided at the third proviso at sub-section (1) (a) mandatory.

Question 76.—Do the principles underlying the assessment under section 34 of the Income-tax Act need any modification?

Section 34 was extensively amended in 1939 because in its old form it had proved to be very much on the side of the evader. The amendment had the approval of the honest assessee although it was thought that the four years limitation period prescribed for cases falling under clause (b) of sub-section (1) tended to offend against the canon of certainty. So long, however, as there was no sanction even after further amendment of the section in 1948 for revision of an assessment merely to correct a mistake in law discovered within the four year period there was no great objection to it. Unfortunately, the position has been rudely disturbed by the recent decision of the Calcutta High Court in *Raja Benjoy Kumar Sahas Roy v. C. I. T.* reported at (1953) 24 I. T. R. 70 according to which information as to the true state or meaning of the law derived freshly from an external source of an authoritative character is definite information within the meaning of clause (b) of sub-section (1) of the section. If such an interpretation of the statute was possible before its amendment in 1948 it is still more so now that definite information need not subsequently be discovered.

The assessee has precisely thirty days within which to take an appeal against his assessment. If within that time he is not aware of the fact that he has grounds for appeal but he is so within one year of the passing of the order, he may apply to the Commissioner under section 33A(2) for revision of his assessment but he has no right of appeal against the Commissioner's order. If the assessee has erred in his view of the true state or meaning of the law the remedies available to him are exhausted upon the expiry of one year from date of the assessment order.

What are the remedies available to the revenue in the same condition? The Commissioner's powers of revision under the old section 33 were abrogated when the Income-tax Appellate Tribunals were set up simultaneously with the enactment of section 34 in its present form but these were later re-introduced. Under section 33B the Commissioner may revise an assessment within two years of the passing of the order but only in case the order is in his opinion prejudicial to the interests of the revenue. The assessee admittedly has a right of appeal against the Commissioner's order under section 33B but it is objectionable that the revenue should have the protection of a two years limitation period while the assessee has only one year in which to discover he has been over-assessed. The Commissioner cannot exercise his powers under the two years prescription in favour of the assessee.

The Commissioner's powers under section 33B were restored because it was thought that re-assessment under clause (b) of sub-section (1) of section 34 did not extend to a case where the assessing officer had made a mistake in law; certainly not to a case where the true state or meaning of the law derived freshly from an external source of an authoritative character. Section 34(1) (b) must now be amended so as to exclude re-assessment in such a case and its limitation period reduced to two years so that the honest assessee may the sooner have a certain determination of his liability to the tax. At the same time the limitation of time for the passing of an order under section 33B must be reduced to one year or in the alternative the limitation of time under section 33A be increased to two years; the revenue may be expected to know the true state or meaning of the law just as well as and no less timeously than the assessee.

Question 77.—What measures would you suggest for simplifying the procedure of assessment in order to reduce the cost of compliance with tax regulations?

The procedure of assessment is not at all complex and requires no great expenditure of time or money so long as the assessee keeps clear accounts and his return of income timeously filed, is accompanied by all necessary supporting data.

Question 78.—It has been suggested that the Appellate Tribunal should have powers to enhance assessments in the same manner as Appellate Assistant Commissioners have. What is your opinion?

The Commissioner has power to revise an assessment prejudicial to the interests of the revenue and in addition section 34 provide powers of re-assessment which, as is now held, extend so as to enable the executive to correct a mistake in law. The Appellate Tribunal is not an executive authority and it is the final arbiter

so far as concerns a question of fact. If powers of enhancement are given to the Tribunal what provision is to be made for an appeal against an order made on a question of fact? There is no merit in the suggestion. Powers of enhancement should vest only in the executive and must be appealable.

Question 79.—Do you recommend that an element of progression should be introduced in the corporation tax?

Question 80.—Would you advocate different rates for different types of corporate enterprises, e.g.,

- (i) small industries;
- (ii) cottage industries;
- (iii) private limited companies or what may be termed proprietary companies;
- (iv) holding companies?

Question 81.—There is a demand for the exemption of intercorporate dividends from corporation tax. Do you consider this justified and, if so, why?

Question 84.—Do you think, in view of the fact that profits distributed by a company are subjected to corporation tax, it is appropriate that they should also be charged to super-tax in the hands of shareholders? If not, what are your suggestions in this regard?

These are connected questions and are more conveniently discussed in the same context.

The corporation tax is of American origin where it was first imposed on corporations possessing certain advantages or privileges as a consequence of the conferment of a government franchise or monopoly. The profits earned were greater than were required to attract capital and to maintain production; the tax was designed to absorb the excess and it was accordingly regarded as a tax on surplus. In its contemporary form in the U. S. A. it is a tax on capital and on dividends paid and it is described at the charging section of Article 9 of the Tax Law of the State of New York as a tax payable by a corporation for the privilege of exercising its corporate franchise. It is not a tax on income.

There was a tax on corporations in the U. K. from 1920 to 1924 when it was abolished to further the development of trade. While in force it was charged at 5 per cent. of the profits of corporations other than public utility companies and building societies.

The tax was first devised when most business was carried on with unlimited liability. The corporation, it was thought, should be made to pay for the privilege of limited liability and juristic personality. Today, the corporation is the normal not the abnormal; the limiting of liability, the right to sue and be sued in its corporate name and the facility of perpetual succession are no longer regarded as privileges but they are in fact indispensable to the provision of finance for the promotion of trade and industry.

The Todhunter Committee in 1925 described it as an impersonal tax; they were of opinion that it was inequitable that income be taxed twice and recommended that the exemption limit be abolished and that thereafter the corporation tax should be allowed as a deduction in the income-tax assessment.

According to Article 366(6) of the Constitution the corporation tax means any tax on income so far as that tax is payable by companies in the case of which the following conditions are fulfilled:

- (a) that it is not chargeable in respect of agricultural income;
- (b) that no deduction in respect of the tax paid by companies is, by any enactments which may apply to the tax, authorised to be made from dividends payable by the companies to individuals;
- (c) that no provision exists for taking the tax so paid into account in computing for the purposes of Indian income-tax the total income of individuals receiving such dividends or in computing the Indian Income-tax payable by or refundable to such individuals.

Although not a tax on incomes falling into the pool of revenue divisible between the Centre and the States, it is brought within charge by section 55 of the Indian Income-tax Act as a super-tax payable in respect of the income of a company by way of an additional duty of income-tax.

What is the corporation tax? Although charged by section 55 of the Income-tax Act by way of an additional duty of income-tax that is apparently done only for convenience of assessment and collection. It has none of the characteristics of the income-tax payable by corporations; the rate of its incidence is varied by a scheme of abatements and it is not treated as the income of the shareholder to be added to his dividend and charged to the personal super-tax.

Is it a tax on privilege? If so, there is no warrant for the differential in the form of the scheme of abate-

ments since all corporations enjoy the privilege in the same ratio as income. That it is not an impersonal tax of this character is suggested by the absence of any provision for its allowance in the assessment to income-tax.

There is already an element of progression to the extent that there is a scheme of abatements regulated only in the case of smaller corporations by reference to the income quantum and in other cases by reference to the territoriality of the dividend declaration and according to the ownership and control. The maximum abatement of public companies whose income do not exceed Rs. 25,000, the distinction made between public and private companies, the minimum abatement allowed to certain foreign companies and its total denial to others associated, as they are, with the amendment by the Finance Act, 1948 of Explanation (3) to section 4 by which certain dividends declared abroad had theretofore been deemed to be income accruing or arising in British India, suggest that the corporation tax is designed to recoup the super-tax otherwise payable by the shareholders if all profits were distributed as dividend in the taxable territories. If that is indeed the character of the tax the charge must logically be abated according as the profits of a corporation are not retained but are distributed and the progressive element more correctly introduced in that form. There should be the optimum abatement when all profits are distributed.

If the corporation tax is neither a tax on privilege nor a tax on retained profits but it is an additional duty of income-tax, there is a case for its being grossed up and credited according to the provisions of sections 16(2) and 18(5) in the assessment of the shareholder as is the first or ordinary charge of income-tax.

There is no case for any rate differential for different types of corporate enterprise if the tax is a tax on privilege since all enjoy the privilege in the same ratio as income. If a tax on retained profits the present additional abatement of one anna for small industries (i.e., units whose income does not exceed Rs. 25,000) and possibly also the reduced abatement for private companies is perhaps logical. If it is an additional income-tax there may be grounds for a differential in favour of smaller and cottage industries.

For so long as the corporation tax and the income-tax are different taxes and no provision is made either for the exemption of the shareholding corporation to its charge or for its credit in the assessment of that corporation the same profits are doubly charged to the same tax. Its double incidence is accountable for the restraint almost to the point of complete elimination of the logical development of trade and industry through specialised companies otherwise to be sponsored by the parent company for the purpose of carrying its subsidiary policies into effect. In England and in the U. S. A. the parent company has provided much of the finance and initiative for the expansion of industry. All argument is in favour of and none against the exemption of intercorporate dividends from charge to the tax.

It is an offence against the fundamental principle of taxation that the same income should twice bear the same tax and it is accordingly urged that just as the income-tax paid by a company is credited to the shareholder, an intercorporate dividend must be corporation-tax-free to the shareholder-corporation which now pays the corporation tax a second time in its own assessment. The case of the individual shareholder and his liability to super-tax is not completely analogous. The super-tax has a different intent and is payable at an increasing scale. There is no case for exemption. If, however, the corporation tax is an additional duty of income-tax, it also should be included in the income of the shareholder and credited to him as tax paid on his behalf.

This Chamber is of opinion that there is pressing need to render the status of the corporation tax less nebulous. That is best done by ascribing to it the character of an additional duty of income-tax designed to recoup the super-tax otherwise lost to the revenue if profits are not distributed and, consistently therewith,

- (a) grossing the part of the dividend which has borne the tax for inclusion in income according to section 16(2);
- (b) crediting the corporation tax inclusion in the income under section 18(5) as a payment of income-tax made on behalf of the shareholder, having the effect also of exempting the corporation-shareholder so long as the rate in the year of assessment is unchanged and the two corporations have the same status in the scheme of abatements.

Question 82.—Do you think that any special provisions are necessary for the assessment of—

- (a) bank; and
- (b) investment companies?

Do existing rules relating to assessment of insurance companies, especially mutual insurance associations, require any change? If so, in what respect?

The Chamber offers no comment so far as concerns banks. The exemption from the charge of corporation tax presently enjoyed by investment trust companies under sanction of the notification of 9th December 1933 should be continued but it would seem desirable that the exemption be sanctioned by statutory amendment rather than by notification, as should all exemptions sanctioned under the powers vested in the executive by section 60 before its amendment.

The Schedule to section 10(7) of the Act requires very extensive emendation. The alternative basis of charge prescribed for the business of life insurance is objectionable not only by reason of its uncertainty but because of the definition of gross external incomes, the limitation of expenses and since, on a change of the basis to charge, Rule 4 operates so as in the one case to preclude credit for part of the tax paid or deducted at the source and in the other to allow credit for more than has been paid or deducted in the aggregate.

There can be no equitable charge to the tax on a basis which may change from one year to another especially when the basis yielding the more revenue is to be employed. Over a period of years this must operate against the company.

The cost of procuration commonly includes the commission of the agent. The commission received upon re-insuring all or part of a risk is nothing more in the hands of the original underwriter than a recovery of the commission paid in the same proportion as the risk is re-insured yet it is included in gross external incomes by virtue of the definition at Rule 5(ii); a recovery of commission is logically to be deducted from commission paid.

The limitation of expenses is in principle wrong. In the computation of what is income, the exclusion of allowance for any expenditure which by the canons of income taxation and by the statute itself is allowed the status of a revenue expenditure is unwarranted.

Rule 4 provides that where an assessment is made in accordance with the annual average of a surplus, credit is not to be given under section 18(5) for the tax paid or deducted at the source during the previous year but for the annual average of the tax so paid or deducted during the intervalation period. In case the basis of charge changes from that of the annual average of a surplus to that of gross external incomes less expenses and that occurs in the assessment next following a triennial valuation and there is no subsequent reversion to the original basis of charge, credit for two-thirds of the tax paid or deducted at the source during the intervalation period is precluded; so much of the tax is lost to the company. Upon the reverse happening the revenue suffers in the same proportion.

The need for a single basis of charge is clearly suggested without a limitation of expenses.

The Insurance Act, 1938, as now amended requires all life insurance companies to make a valuation at least once in every three years. This amendment has adversely affected companies whose practice it was to make a valuation every five years. The involuntary shrinkage of the intervalation period has caused numerous companies substantial loss by reason of the exclusion of credit for tax paid or deducted at the source to the extent of one-fifth in some cases or in others two-fifths of the tax so paid or deducted during the preceding quinquennium. Neither Act nor Schedule provide any remedy; the revenue is apparently indifferent to the submissions made on the point. It is no answer for one department of Government to say that the loss caused to life insurance business as a direct consequence of an amendment of the law sponsored by another department of the same Government derives from one of the several anomalies inherent in the Schedule by which the revenue also may suffer. It should be a matter of some concern to Government which in other ways is commendably anxious to secure the development of life insurance on a sound footing. The remedy lies in a refund to the company, either in one instalment or two, of the tax excluded from credit, subject to the deduction of any credit for tax in excess of that actually paid or deducted which the company has at any time enjoyed either as a consequence of a change in the basis of charge or by reason of an extension 'sou motu' of the intervalation period.

Question 83.—Do you think that differentiation should be made between distributed and undistributed profits of companies for tax purposes? If so, on what grounds? What change would you suggest in the present quantum of differentiation in favour of undistributed profits? Should the concession in future be restricted to particular industries?

If the tax concession in favour of undistributed profits is allowed to continue as at present or in a modified form, what measures would you suggest to ensure:

(a) that retained profits are not used as a device by shareholders of private limited companies to evade super-tax;

(b) that retained profits are actually applied for productive purposes?

In particular, are the provisions of Section 23A of the Income-tax Act satisfactory? If not, what changes would you suggest?

There is a close connection between the purpose underlying the differentiation and the condition in which trade and industry must conserve their resources and so survive. The differentiation is designed to go some way to counteract inflation. A policy of dividend limitation is to be observed if provision is to be made for the replacement of capital assets, materials and merchandise expended during the inflationary period. The former encourages the latter and so the two are complementary. It is accordingly thought that the differentiation between distributed and undistributed profits must continue for so long as no alternative adequate relief is provided for the replacement of assets. If at all changed the abatement of income-tax allowed since 1948 must be increased.

The private sector is to make an important contribution to India's 5-Year Plan. That contribution is not to be made only by the industrial undertakings to which sections 15C and 56A of the income-tax Act apply but it is to be made also by undertakings established before 1st April, 1948 and by industries other than those specified. There is no case for a restriction to particular industries. Nor is there better assurance for the employment as a contribution to the Plan of any higher dividends paid as a consequence of denial or restriction of the differentiation.

The private limited companies referred to at the second part of the question are presumably those to which section 23A applies. The word 'evade' at question (a) is presumably intended to be read as 'avoid'.

There is in fact no direct connection between the retained profits of private companies and the income-tax abatement referred to as a concession in favour of undistributed profits. Under section 23A the quantum of the dividend to be paid is virtually regulated and compelled. It is not appropriate to ask how, having been encouraged to observe a policy of limitation by the grant of a concession, there may be assurance that there is no super-tax avoidance.

Section 23A permits a private company to save some 22½ per cent. of its income and its shareholders to escape super-tax in the same proportion. Is it implicit in the question that only a public company must reserve a part of earnings against the hazards of an uncertain future or for development of its undertaking? So long as saving is considered a virtue and the tax is payable only on what is income, the super-tax must be avoided to the shareholder to the extent that the private company does not distribute all of its earnings for so long as the saving is less than the capital.

In the wider sense the retention of profits is by itself productive to the extent that there is a saving available for investment. It is not true to say that profits saved and reserved primarily for the protection of capital and not employed to increase the productive capacity of the existing unit are not applied for a productive purpose.

These criticisms lie against section 23A:—

- (a) it should not apply to a company in which more than 50 per cent. of the voting power is controlled directly or indirectly by one or more companies in which the public are substantially interested;
- (b) the liability of the shareholder may be uncertain for so long as six years after the dividend is declared; there should be a time limit for certainty which may conveniently be ninety days after the date at which the time for taking any appeal against the company's assessment has prescribed and no appeal is pending;
- (c) the profits to be distributed for the avoidance of its provisions should be only one-half of the remainder after the payment of taxes, leaving one-half for saving; very few public companies distribute so large a proportion as 60 per cent. of the residue;
- (d) account should be taken of losses subsequently suffered so far as these are ascertained before the date of the passing of any order when the shareholders may have lost all or part of their capital;
- (e) account should also be taken of distributions in preceding years exceeding 60 per cent. of the residue; these should be carried forward and set off against any short-fall appearing in the year under review;
- (f) the company should have opportunity to distribute the shortfall from 60 per cent. after the assessment is final;
- (g) income of a notional character such as that brought within charge by sections 42(2) and

10(2) (vii) should be excluded from the assessable income;

(h) profits whose remittance is blocked should be excluded from assessable income;

(i) a sum paid for a licence to manufacture or for technical assistance whether in cash or in shares being in the nature of capital or deferred revenue expenditure and so not admissible as a deduction under section 10(2) and other expenditure of a quasi-capital nature laid out to acquire or exploit a wasting asset should be treated as a deduction from assessable income to the extent to which it is charged against the profits of the year;

(j) sums reserved for the payment of retiring gratuities to workers and for the rehabilitation or replacement of assets should be treated as a deduction from assessable income; and finally;

(k) the executives are variously interpreting the decisions in *Sir Kasturchand Ltd.*, and *Ezra Proprietary Estates Ltd.*; the department should publish an official interpretation so that private companies may know what treatment to expect; it is of no consequence and there will be no grounds for complaint if a conflicting or over-ruling judgement later appears

Question 85.—Would you consider that industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies should be required to contribute, from their earnings in the way of income-tax or in other ways, to general revenues?

As a general rule the income of all State or Local Government enterprise should be charged to the taxes on income; the measure of efficiency in its conduct is not otherwise to be properly disclosed and unfair competitive capacity is added against the private sector in the same sphere. There are exceptions to that rule. Certain services are virtual monopolies of the State as railways, posts and telegraphs and the provision of ordnance and of local Governments as the supply of water. On the other hand, the income of State or local Government enterprise which is also in the sphere of the private sector or which operates in the same field as private enterprise should not be exempted from the charge. Notable examples are power and road transport, the supply of milk, brewing and distilling and the manufacture of anti-biotics.

Question 86.—What measures would you suggest for the greater use of the services of Chartered Accountants for assisting in the determination of the taxable income of assessee? What obligations should be placed on a Chartered Accountant when he certifies a statement of accounts of an assessee for purposes of income-tax assessment? In particular, with a view to minimising evasion of tax, would you recommend that the certificate of a Chartered Accountant should invariably accompany the return for business income over a certain limit? If so, would you suggest that a form of certificate should be prescribed indicating the scope of the check that should be exercised by Chartered Accountants who render the certificate mentioned above? Do you agree that fees payable by assessee to Chartered Accountants for such certificates should be restricted to a schedule to be prescribed by Government?

The question appears to contemplate and propose amendment of the Act so as to require (a) every business assessee to employ a chartered accountant and (b) a chartered accountant so employed to certify the assessable income. Even in cases where the accounts are presently audited and certified for compliance with the relative provisions of the Companies' Act, performance of the audit does not necessarily require that degree of research necessary for the computation of the assessable income or, at the least, for the disclosure of expenditure not to be allowed as a deduction under the Income-tax Act. The accounts of business are designed to disclose a true and correct view of the state of the business according to and consistent with normal commercial principles and practice and the statutory law, not including the income-tax law. They are not designed to disclose the assessable income. The proposal is considered wholly impracticable and accordingly the further questions as to how it may be carried into effect do not arise.

Question 87.—What changes would you suggest in the present law relating to the representation of assessee before Income-tax authorities (section 61) in order to ensure—

(i) effective representation of assessee at reasonable fees;

(ii) a minimum level of proficiency on the part of representatives regarding the subject of income-tax law, rules and regulations?

The question in its first part, appears to suggest that the assessee is not now effectively represented for a

reasonable fee; if that is so it is a state of affairs for which the assessee is himself responsible. Adequate representation at moderate cost is available to the honest assessee; is it possible that the scale of the representative's remuneration varies in direct ratio as the degree of evasion practised by the assessee? Sub-section (3) of section 61 should be amended to provide more rigorous penalties for misconduct on the part of a representative.

Question 88.—Will it assist in checking evasion if the names of the persons who are penalised for concealment of income are published?

At the least the publication of the names of persons penalised for evasion will not encourage its practice. So long, however, as public opinion is insensitive and unresponsive only the least odium will attach to the person whose name is published. If evasion is to be checked section 52 should provide for rigorous imprisonment for a longer term without the option of a fine and sub-section (2) of section 53, giving the Inspecting Assistant Commissioner power to compound the offence, should be repealed.

Question 89.—Do you think that the present practice of excluding, from taxable profits, perquisites given to employees of business undertakings results in considerable loss of revenue? If so, please state the perquisites you have in mind, and how they should be dealt with for the purposes of taxation.

The allowance to be made in computing the profits of business are specified at section 10(2) and include (clause xv) any expenditure laid out or expended wholly and exclusively for the purpose of the business. The exclusions from taxable profits are both in law and in practice only the allowances specified at section 10(2). There is no sanction for the allowance of a perquisite as such although anything which may come within its meaning in the hands of the employee may be admissible as a deduction under section 10(2) as an expenditure laid out or expended wholly and exclusively for the purposes of the business. That test is invariably applied when computing the profits of business.

Question 90.—In the case of a company under liquidation, what steps if any would you suggest for safeguarding payment of tax dues before any payments are made to shareholders?

This question is closely concerned with that put at No. 95 and possibly also that put at No. 94. It is prerequisite to recovery of the tax in all cases that both assessment and recovery proceedings be instituted without delay.

The question is not too happily conceived. The State has precedence at common law in respect of income-tax arrears over unsecured creditors. Under the Companies' Act the State enjoys a substantial degree of priority in respect of taxes which have become due and payable within one year before the commencement of the winding-up or the date of the winding-up order according as it is a voluntary or a compulsory winding-up. If the completion of assessments has been delayed and orders are passed and demands issued only after the company has been taken into liquidation the State has no priority in respect of such demands. The question of safeguarding recovery once the company is in liquidation arises only if it is contemplated that the department may neglect to file a notice of claim or that the liquidator may alienate assets which have come to his hands. No form of safeguard should be necessary to protect the revenue against the first contingency. If assets are alienated the liquidator renders himself personally liable for the loss to the revenue under the provisions of the Companies' Act.

Question 91.—Do you think that, in order to minimise evasion and avoidance of tax, there is a case for conferring larger powers on income-tax authorities? If so, what further powers should be given to them? In particular, should powers to search premises and seize documents and books of accounts be given to income-tax authorities? If so, what is the lowest grade of officer on whom you would confer these powers?

The reference to avoidance in the same context as evasion is inappropriate. The subject is entitled so to arrange his affairs as to avoid the tax or reduce his liability to it so long as that is not done in breach of the law. The powers conferred by the Act, if honestly, vigorously and intelligently applied, are already adequate for the detection of evasion. Any encroachment on the liberty of the subject as the question contemplates would be intolerable and it is thought unlikely, in any event, that the dishonest assessee who practices evasion by concealing his transactions will keep accounts and documentary evidence where they are likely to be discovered, if at all he keeps them. The investment of further powers in the executive officers of the Department has no popular sanction judged by the fact that the Select Committee amended the Bill of 1952 by requiring the previous approval of the Commissioner for the exercise of the power to require submission of a statement of wealth.

Question 92.—What precautions are necessary and possible to prevent the creation of an artificial legal entity—a trust or a private limited company or a partnership, especially family partnership—either for avoiding payment of income-tax or for fractioning of income to escape higher rates? Would you recommend the use of penalty rates of tax to minimise such practices?

The expression "artificial legal entity" is a novel one and its meaning somewhat obscure. Reference is presumably intended to cases where the existence of a partnership is held out where none, in fact, exists but one or more of the partners are real and the others bogus or where a trust claiming to escape the mischief of sub-section (3) of section 16 has been created but the settlor continues to enjoy the income or a company formed with capital subscribed by nominees of the person providing it who alone is in receipt of the dividends paid. In such cases it is for the executive to register the partnership or not, to tax the trust income as the income of the settlor if the beneficiaries do not enjoy the income and to tax the dividends as the income of the real owner in case the nominees are not able to show that they acquired the shares from their own monies and they have received the dividends for their own account and advantage. When application is made for registration of a partnership the onus of proof is upon the persons making the application. In the other classes of cases the onus of proof is on the Department.

In all such cases the person seeking to avoid or reduce his liability to the tax should be liable under the Act's penal provisions if he is not now so liable.

Question 93.—In the case of a registered firm, would you advocate recovery of unrealised tax of any partner from the firm as such or from other partners?

This Chamber is against any proposal for recovery of the tax from a person or persons not enjoying the income.

Question 94.—Are present arrangements relating to recovery of income-tax adequate? Would you advocate the Income-tax Department having separate machinery for enforcing the recovery of arrears of tax?

The existing provisions for the recovery of arrears are quite adequate and no separate machinery is necessary. The question at its second part refers specifically to arrears of tax but there would be less non-recovery if assessments were timeously completed. That the question should at all arise appears to suggest only that assessments are not made nor is action for recovery taken in time.

Question 95.—What provisions should be made to ensure timely collection of tax from private limited companies? Do you consider that liability for payment of tax in such cases should be placed upon shareholders of the company in proportion to their shareholdings?

Timely assessment is pre-requisite to timely collection of the tax. Assessment proceedings must be rigorously instituted especially in cases where no payment has been made under section 18A or no provisional assessment made. While regretting that evasion of the tax may be possible by an alienation of assets this Chamber is strongly opposed to any proposal designed to transfer the liability for its payment to the members of the company. Such an alienation of assets is a fraud on the revenue; it is for the department to see that suitable provision is made for its punishment if indeed such provision does not now exist.

Question 96.—If income from any property is included for assessment purposes in the hands of a person other than the ostensible owner, would you agree to the tax so assessed being also made recoverable from such property?

It is assumed that what is envisaged here is an amendment to the Act providing for attachment of property for the purpose of recovery of tax from an assessee who has included in his return income from that property although the property stands in the name of another. Presumably such an amendment would be on the footing that the fact that the income was included in the assessee's return is evidence of his beneficial ownership of the property. This would not appear to be objectionable. If a person enjoys the income from any property it seems reasonable that the property should be security for the tax payable. A provision would however have to be made for trust property. If the assessee merely had, say, a life interest it would not be proper for the trust fund to be destroyed. If action was being taken on the lines suggested it would also be necessary to make provision for the assessee or any other person interested to prove that the property did not in fact belong beneficially to the assessee.

Question 97.—What concrete measures should be taken to improve the relations of the Income-tax Department with assessee, especially in regard to—

- (i) provision of free advice to small assesseees on the following points :
 - (a) maintenance of accounts in a form acceptable to the Income-tax Department; and
 - (b) matters such as filling returns of income, claiming refunds, facilities for tax payment, expeditious disposal of assessments, etc.;
- (ii) provision of information on various matters relating to assessment proceedings, such as, disposal of refund applications, adjournment applications, examination of records, etc.;
- (iii) arrangement of work so as to obviate the necessity of assesseees or their representatives having to wait in Income-tax Offices for unduly long periods; and
- (iv) securing of the largest measure of agreement on facts between the assessee and the department at Income-tax Officer level?

In a condition in which the rates of tax are so high as to be considered oppressive, many assesseees exercise the utmost of their ingenuity to conceal their incomes and the tax department has been rapidly expanded and includes a high proportion of relatively inexperienced officers, a measure of mutual distrust and resentment is perhaps not entirely avoidable.

The Income-tax Investigation Commission made a number of recommendations at paras. 443, 444 and 445 of their Report to the end that there should be an improvement in relations between the department and assesseees. These enjoin a certain course of conduct upon the Income-tax Officer but the Commission was critical of a system in which his ability is measured by his success as a collector of revenue. It appears too frequently to be the case that the Inspecting Assistant Commissioner is responsible for the continuance of the state of affairs proposed to be remedied by the Commission.

Apart from the generality the remedy lies with the Department so far as concerns these practices in particular:—

- (a) appropriation of a refund due against a dormant demand (e.g., tax attributable to D. I. T. relief) in breach of Central Board of Revenue instructions;
- (b) the postponement of a section 23(3) order when that will result in a repayment of all or part of the instalments paid under section 18A; the Department should secure amendment of the Act to make a provisional assessment mandatory within 30 days of the filing of the return;
- (c) delay in giving effect to orders passed in appeal or in revision in case a repayment is to be made;
- (d) the adverse exercise of the discretion allowed by the third proviso to section 18A(1); when the assessment of a subsequent year is completed and the income assessed is less than was assessed in the preceding year there should be no abstinence from exercise of the discretion but the lower demand for payment in advance should be substituted;
- (e) requiring the attendance of the assessee for an undisclosed purpose which may prove to have no direct bearing on any pending assessment; the inquiry is more conveniently made in writing;
- (f) including in the income assessed an expenditure concerning which no inquiry has been made during the assessment proceedings thus causing the inconvenience and cost of taking an appeal which must and does succeed.

The Investigation Commission discussed the difficulties arising out of small assessments at para. 201 of their Report but made no recommendations so far as concerned maintenance of accounts in a form acceptable to the Department. At para. 446 of their Report they discussed a proposal for the appointment of an Inquiry officer whose duty it would be to help small assesseees to complete their income returns but they viewed more favourably a proposal for the appointment of a Complaints officer whose duty it would be to look into complaints and grievances of a general character. Proceedings in any assessment must be completed in a spirit of mutual co-operation if both the Income-tax Officer and the assessee are to be satisfied with the result. There is a tendency, however, to emphasise too much the responsibility of the Income-tax Officer and too little that of the assessee. The limit of exemption is not now so low as to warrant the presumption that the assessee is entirely ignorant of the significance of the assessment procedure; a solution for present difficulties may be found if the Commissioner were to maintain a panel of persons entitled under section 61 to appear in proceedings under the Act who would advise small assesseees on the maintenance of accounts, the filing of returns, refund applications and appeals at a time scale of

remuneration which need not be disproportionate to the resources of the class of assessee for whose benefit the panel would be maintained. It would be necessary to prescribe the upper limit of income of the class entitled to the benefits of the arrangement, the principal merit of which would lie in the fact that the small assessee would no longer be entitled to complain that he is unjustly assessed only because of his ignorance of his rights under the Act.

The largest possible measure of agreement on facts may be secured if the Department will devise a questionnaire in a standard form appropriate to each type of business carried on and the assessee is required to complete that questionnaire and to file it with the income return and if the Income-tax Officer makes proper inquiry concerning a receipt or an expenditure before including it in the income assessed.

Question 98.—What changes would you suggest in the existing arrangements relating to:

- (i) issue of notices;
- (ii) simplification and filing of returns;
- (iii) levy of penalties;
- (iv) recovery of tax; and
- (v) appellate procedure and machinery, particularly with reference to administrative control over Appellate Assistant Commissioners?

The investigation Commission discussed at some length the representations made concerning the status of Appellate Assistant Commissioners and recommended (numbers 148 to 151) that they be removed to the control of the Appellate Tribunal, a number of senior subordinate judges be recruited as well as persons holding appointments in the Judicial and Income-tax departments and they should have the prospect of promotion to the Appellate Tribunal. These recommendations have not been adopted.

On the contrary the Finance Minister has recently been reported to have expressed himself in favour of the status quo on the grounds that the first appeal against assessment in other countries is to be made to an executive of the tax department. That is certainly not so in the United Kingdom where the powers of assessment are vested in Commissioners of several classes who also are to hear and pass orders in appeal. The only qualification of these Commissioners is that they are persons of substance and respectable citizens.

By training and experience the Appellate Assistant Commissioner is unsuited to the discharge of a judicial function. In spite of the administrative instruction on the point it is patent that his decisions are influenced by considerations of revenue and promotion prospects. The assessee's appeal is frequently upheld if the Income-tax Officer has quite clearly gone wrong but only rarely if its upholding requires the assumption of any degree of independent responsibility. He is under the control of the Central Board of Revenue not only so far as concerns the persons or classes of persons or incomes or classes of incomes and the area in respect of which he is to discharge his functions; it is possible to bring evidence to show that the control extends to denial of the benefits of a rule established by one of the High Courts.

Every argument is in favour and none against adoption of the recommendations of the Investigation Commission.

Question 99.—(a) Do you think that undue delay occurs at present in the course of assessment proceedings? If so, what do you attribute this to and what are your suggestions for remedying this?

(b) In order that delays of the kind mentioned above do not appreciably affect collection of a substantial portion of the tax due, should any special concessions be provided to assessee to induce them to make advance payment of tax?

There is no doubt that the completion of assessments is in many cases unduly delayed in these circumstances:—

(a) the income return and the assessee's accounts indicate a loss;

(b) a provisional assessment has been made under section 23B;

(c) the income return and the assessee's accounts indicate that completion of the assessment must result in repayment of all or part of the tax paid in advance under section 18A;

(d) the assessment is large or is complex requiring time and labour; it counts only as one of the quotas to be completed and accordingly completion may be deferred until the limit of time prescribed at section 34(3) is about to expire; in the meantime the Officer may be transferred or promoted.

The remedy lies in amendment of the Statute so as to reduce the period of limitation in cases not falling under section 34(1) by two years.

There need be no consequent delay in collection of the tax due. In cases where section 23B cannot be invoked for want of the income return, the Officer may

in the alternative exercise his powers under section 23(4). The question of need of special concessions to induce advance payment of the tax does not arise.

Question 100.—What, in your opinion, would be the circumstances which would justify the levy of Excess Profits Tax or special business taxes?

The levy of an Excess Profits tax or special business taxes is justified only in case trade and industry is otherwise to secure an advantage not to be enjoyed by the individual as in a state of national emergency. In the inflationary conditions created by a state of war, actual or potential, the profits accruing to trade and industry from the increased expenditure of public money should be recouped by the State through the medium of a tax designed for that purpose without at the same time promoting inflation, inefficiency and reckless expenditure as did the Excess Profits tax introduced in 1940.

Question 101.—What are your main reactions to the Estate Duty Bill at present before Parliament?

In the context of the modern concept of social justice and clause 2(b) of the Commission's terms of reference which refers to the objective of reducing inequalities of income and wealth the proposed Estate Duty is unexceptionable. It may have no popular appeal since the subject can never unreservedly approve a new tax but the proposed duty has the merit that it can never reasonably be said to destroy the incentive to produce and to earn; there is greater merit if the revenue from the duty is applied to reducing the tax burden on incomes.

The need for international conventions for avoidance of double duties should not be neglected.

Question 102.—Would you in the matter of rates of levy differentiate between self-acquired property forming the estate of a deceased and property inherited by him?

There should be no differentiation between rates of duty in the case of self-acquired property and inherited property; it would be extremely difficult in practice to do so as there would be endless disputes as to which was which. If Estate Duty is to be levied at all there are no grounds for such a distinction. Provision must, however, be made for the grant of relief in a case of quick succession so that the same property does not at once take the full blow of a second levy of duty. The Bill, as drafted, so provides.

PART III—COMMODITY TAXES (CENTRAL AND STATE)

CUSTOMS

Import Duties.

Question 103.—Do you think that any changes are necessary in the Indian Customs Tariff in respect of—

- (i) grouping of commodities;
- (ii) additions to and alterations in tariff items;
- (iii) correlation with the Import Trade Control Schedule;
- (iv) clarification in nomenclature and in units of measurement or weight.

The Chamber has felt for some time the need for revising the Customs Tariff Schedule, and when Dr. P. M. Mukerji, the then Director-General of Commercial Intelligence and Statistics, was deputed by the Government of India in July 1952 to revise the Import Trade Control Schedule, he was asked when he met representatives of the Chamber in Bombay, whether this revision of the I.T.C. Schedule was going to assist in any way in correlating it with the Customs Tariff Schedule. His answer to this question was that the Customs Tariff was outside his terms of reference. It became increasingly evident that importers generally were experiencing hardship due to the differences in the description of goods existing in the two schedules which involved them in numerous disputes with the Customs. This Chamber accordingly took the opportunity to move the following resolution at the Annual General Meeting of the Associated Chambers of Commerce held in December 1952, which was adopted unanimously and forwarded to the Government of India:—

"This Association recommends to the Government of India that, while the Import Trade Control Schedule is being revised, the opportunity should be taken also to revise and enlarge the Indian Customs Tariff to make it more suitable to the present-day pattern of trade and to correlate with it, so far as possible, the Import Trade Control Schedule."

The Import Control Schedule as it stands at present contains, in Parts I to VI, 601 items each of which has been given a serial number, and in many of the serial numbers there are further sub-divisions. In the First Schedule to the Indian Customs Tariff, which regulates the rates of duty to be charged on every dutiable article entering this country, there are only 87 items, the last

one being "all other items not otherwise specified, including articles imported by post". Since this Import Tariff was framed the pattern of the country's trade has undergone a substantial change. A number of items specifically provided for in the Tariff are not now imported; some were specifically included to meet special circumstances not now arising. On the other hand, there are numerous new commodities and articles which are not included except under a general heading. To enumerate the large number of commodities of all kinds and sorts, particularly under the heading of "Chemicals, Drugs and Medicines", which now form a part of the trade of this country but did not do so when the Tariff was framed, would take much too long. In any event, it is unnecessary because the answer is to be found in the Import Control Schedule.

The situation today is that there are hundreds of items in this Schedule which are licensed for import under varying conditions and in respect of which it is quite impossible for importers to ascertain from a reference to the Customs Tariff what duty will be payable on the goods when they arrive, or even whether they will be allowed clearance. The doubt about clearance of the goods arises because, in many instances, when an importer is applying for a licence he cannot definitely state in his application the item number in the Customs Tariff under which the goods will be classified. There have been numerous cases in which importers have received licences for the import of certain commodities and, relying upon these licences, have arranged for the import of the goods, only to learn on arrival that they are quite differently classified by the Customs Authorities. In the result, penalties have had to be paid and, pending settlement of the matter, heavy demurrage charges have been incurred.

Another difficulty which arises is in regard to Open General Licences. An importer may order certain goods, the description of which, in his opinion, tallies with that given in the Open General Licence. On arrival of the goods he may find the Customs Authorities taking a different view and so classify the goods that a specific licence is necessary. The importer is then faced with the charge of bringing in unauthorised goods and, again, the question of a penalty arises or, in the alternative, the goods are confiscated or ordered to be re-shipped. Resulting from the extreme difficulty of reconciling the Import Trade Schedule items with the Customs Tariff items, *bonâ-fide* mistakes have occurred which frequently have proved to be very costly. The correct understanding of the Import Tariff is not made any easier by the numerous footnotes referring to amendments made from time to time by Government notifications. For example, against the item "Chemicals, Drugs and Medicines, all sorts", there are no less than eight asterisks and other marks necessitating reference to an equal number of footnotes.

Dr. Mukerji, it is understood, has now submitted his report to Government and his proposals for a revision of the Import Trade Control Schedule are possibly under consideration. It is therefore suggested that an early opportunity should be taken to have the Customs Tariff Schedule revised on the same lines, so that the descriptions of articles in both the Schedules will be uniform. Only then will it be possible for importers to estimate beforehand what rate of duty they may have to pay on the goods they import, provided of course the goods conform to the description given.

The units of weights and measures adopted should accord with international standards.

Question 104.—(i) What considerations should govern the fixation of rates of import duties for different groups or sub-groups of commodities or for special tariff items?

The primary considerations should be revenue and the protection of industry to the extent recommended by the Tariff Commission. Rates should be fixed with due consideration to the importance of each item in the country's economy.

(ii) Have you any modification to propose in the present rates of duties in the light of the considerations suggested by you?

The Chamber is of opinion that certain duties afford too great a measure of protection to indigenous industry, with the result that the latter does not always find it necessary to improve quality.

(iii) Do you consider that import duties should be reduced in respect of any specific commodities in order to reduce the scope for smuggling?

No comments.

(iv) Are there any cases within your knowledge where duties on the constituent parts are higher than on the finished product? Is there adequate justification, in your opinion, for this differentiation?

No comments.

(v) Do you think that owing to high rates of duties the yield on any commodity has reached the point of diminishing returns?

While it is true that high rates of import duty are likely to have an adverse effect on the volume of

imports and consequently on customs revenue, in a system of rigorous import control it is not possible to assess whether a point of diminishing returns has been reached.

Question 105.—Is the relative use of ad valorem and specific duties in the Indian Customs Tariff satisfactory? If not, in what respects would you enlarge or restrict the scope of application of either, whether used singly or in combination?

The present use of ad valorem and specific duties as laid down in the Customs Tariff Schedule is working satisfactorily and the Chamber recommends no change in the scope of application of either.

Question 106.—(i) In what circumstances would you consider 'tariff values' a satisfactory basis for assessment of import duties? (Section 22 of the Sea Customs Act.)

(ii) Are there any commodities to which you would extend the application of "tariff values"?

(iii) What changes, if any, should be made in the procedure for determining 'tariff values'?

Tariff values should be fixed only in respect of those commodities whose prices are fairly stable throughout the year. Before tariff values are fixed it is recommended that the trade should be consulted, as experience in recent months has shown that there have been instances where tariff values have been fixed in relation to market prices which existed several months prior to the enforcement of the tariffs and when they were unduly high.

Question 107.—(i) What changes in your opinion are necessary in the present provisions (Section 30 of the Sea Customs Act) regarding the determination of 'real value' and why?

The Chamber is very seriously concerned at the manner in which the Customs authorities disregard the statutory provisions of the Act in regard to the determination of real value under section 30 and at the methods of assessment now employed. As a consequence importers are unaware of the extent of their liability under the Sea Customs Act. The Chamber submits that Collectors should first advise importers of their proposed intention so to alter the methods of assessment, and the reasons therefor, and should grant an opportunity to the importers to discuss the matter with the appropriate authority in the Customs House before action for assessment is actually taken. Article (vii) of the General Agreement on Trades and Tariffs which was signed at Geneva on the 30th October 1947, to which India is a signatory, lays down the broad general principles of valuation for customs purposes, and paragraph 2 of this Article which covers actual value, reads as follows:—

(a) The value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed, or of like merchandise, and should not be based on the value of merchandise of national origin or on arbitrary or fictitious values.

(b) 'Actual value' should be the price at which, at a time and place determined by the legislation of the country of importation, and in the ordinary course of trade, such or like merchandise is sold or offered for sale under fully competitive conditions. To the extent to which the price of such or like merchandise is governed by the quantity in a particular transaction, the price to be considered should uniformly be related to either (i) comparable quantities, or (ii) quantities not less favourable to importers than those in which the greater volume of the merchandise is sold in the trade between the countries of exportation and importation."

Paragraph 5 of the same Article states that the basis and methods for determining the value of products subject to duties or other charges or restrictions based upon or regulated in any manner by value should be stable and should be given sufficient publicity to enable traders to estimate with a reasonable degree of certainty the value for customs purposes. It is recommended that Collectors of Customs should be asked to adopt this procedure so as to enable importers to know in advance their liability for customs duty. The same principles should be adopted in the assessment of export duties. Reference may be made to the Chamber's reply to Question 113.

(ii) Would you suggest any specific measures to counter the evasion of import duties through deliberate under-valuation?

If the Customs appraiser considers that a shipment is under-valued, he has the power under Section 30 of the Sea Customs Act, to make an assessment on the market value subject to the present right of appeal.

(iii) Have the methods of valuation in the Sea Customs Act proved satisfactory in relation to trade through the Land customs border, especially on the Indo-Pakistan border? If not, have you any specific suggestions to make in this regard?

The Chamber has no comments to make on this question.

Question 108.—What changes would you suggest in the matter of granting exemptions from, or reductions in, import duties especially in regard to:

- (1) raw materials used for essential industries;
- (2) materials used for scientific research;
- (3) materials imported for charitable and humanitarian purposes;
- (4) materials imported for stimulating desirable activities, such as agricultural development; and
- (5) necessities of life?

All of the materials to which reference is made and as well the capital plant and equipment for industry should be exempt from duties or at the least bear the lowest rate of duty.

Question 109.—To what extent do you think revenue might be sacrificed in the interests of bilateral and multilateral fiscal arrangements such as G.A.T.T. or the preferences in favour of certain Commonwealth countries?

Revenue may be sacrificed in the interests of bilateral and multilateral trade arrangements.

Question 110.—Under what circumstances should customs duties be used in preference to import quotas as a means of restricting imports?

Reference may be made to the reply to Question 104(1); the primary considerations which should govern the fixation of rates of import duties are revenue and the protection of industry. So long as foreign exchange control is necessary the restriction of imports by a manipulation of customs duties cannot be practicable.

Import control for the purpose of protecting indigenous industry should only be resorted to when recommended by the Tariff Commission after due enquiry and only to the extent that may be recommended by the Tariff Commission.

Question 111.—In what respects should the present law regarding "drawbacks" and "warehousing" be altered in order to assist the export trade in manufactured goods which involve the use of imported raw materials?

The principle of drawback should be extended to all exports of manufactured articles in which imported raw material is used.

Question 112.—Have you any suggestion to make regarding the administration of the Sea and Land Customs Acts, especially in regard to—

- (a) facilities for settlement of disputes arising out of appraisement;
- (b) penalties imposed under the Act and the appellate procedure relating to them?

There is at present no statutory provision for the settlement of disputes arising out of appraisement nor any right of appeal from an order of the Chief Customs Authority for which the discretion vested in the Central Government under Section 191 of the Sea Customs Act is unsatisfactory.

Article X of the General Agreement of Tariffs and Trade, to which India is a party, requires the setting up of tribunals for the prompt review and correction of administrative action. Existing procedures do not 'provide for an objective and impartial review of administrative action' and India is accordingly not entitled to claim exemption from the operation of the covenant. Regardless of the provisions of GATT there is a compelling need for independent judicial machinery for the prompt review and correction of administrative action. Reference may be made to the Chamber's replies to questions 107 and 113.

Export Duties.

Question 113.—Under what circumstances, in your opinion, should export duties be imposed?

An export duty should be imposed only when there is need to maintain parity between internal and external prices. It should never be imposed for revenue considerations. Necessarily operating with retro-active effect, the sanctity of the contract is violated. According as the contract provides, the duty imposed is a loss either to the exporter or to a foreign buyer who has already re-sold the goods. An example of the retro-active effect of an export duty and flagrant disregard of the sanctity of contracts by the executive is provided by the action taken by the Indian Customs in 1952 when the method of assessing the duty on manganese ore was summarily altered, setting aside contract prices theretofore accepted as the basis of assessment and substituting an arbitrary value at the time of shipment. In the result forward contracts made in a rising market as long as two years previously are artificially surcharged as much as 90 per cent. above the official rate of duty. Buyers are naturally incensed and conclude the Indian Government would revert to the contract price basis if the market were to fall. Their search for alternative sources of ore is therefore intensified and with reported good prospects of success in Brazil and Africa in both of which new mines are in process of development.

Question 114.—What measures would you suggest to achieve greater flexibility in the rates of duties to accord with the changing conditions of export markets?

Bureaucracy does not quickly respond to altered conditions; duties are tardily withdrawn or relaxed after the event and foreign markets are lost. Once imposed the effect of an export duty must be closely watched and careful attention paid to the advice of the non-official advisory committees at each major port.

Question 115.—Would you suggest that the whole or a part of the receipts from certain export duties should be funded for financing schemes for promoting long range development of the export trade, subject to the obligations under G.A.T.T.?

The Chamber is generally opposed to the appropriation of a tax or duty for specific purpose. Long-range development may be left to the interests concerned.

Question 116.—Would you in the interests of revenue or from any other point of view, recommend increased participation by the State in import and export trade? If so what form do you think should such participation take?

The function of Government should be confined to such legislation and controls as may, in the circumstances existing at the time, be necessary to ensure an overall balance by, for example, exchange control and quantitative control of exports and imports where this is necessary, either because of shortages of certain commodities or to ensure that available foreign exchange is expended on essential imports. Except in these circumstances or in the event of a grave emergency the State should not participate in the country's foreign trade on any basis, either monopolistic or otherwise. The machinery of Government is not equipped for efficient operation in the sphere of commerce.

Central Excises.

Question 117.—Do you regard as satisfactory the present selection of commodities for purposes of levying excise duties? If not, what changes would you suggest and why?

There is nothing inappropriate in the levy of excise duties on articles of common use or consumption in a country where so few have the capacity to bear any form of direct taxation and so large a part of the revenue must come from indirect taxation. The duties are appropriately imposed *inter alia* on articles whose import from abroad is prohibited or precluded by prohibitive import duties.

Question 118.—(i) Have you any changes to suggest in the present rates of excise duties?

- (ii) Are the provisions regarding valuation satisfactory where ad valorem excise duties are levied?

The rates of duty should be more flexible; at the same time imports should not be prohibited nor precluded by high customs duties. There should be a constant equation or near-equation between the two so that regular imports may be possible. In the absence of that check the rate of the duty is fixed only by reference to revenue considerations; the indigenous industry as a whole need not produce at an economic cost and the price to the consumer is accordingly higher. The more efficient units in the industry would be able to sell in competition with the imported article if excise and import duties were co-related.

The incidence of the duty on competing commodities should be equal.

Question 120.—Do you think that the lower rate of duty on the cottage match industry has been helpful to its development? If not, would you suggest any change in the existing rates of duties?

The Chamber is informed that the differential favouring the cottage match industry has resulted in its substantial growth between 1946 and 1950.

Question 121.—Do you think that the arrangements for the assessment and collection of excises in respect of manufactured and unmanufactured commodities require simplification? In particular, please comment on the present system as regards

- (a) licensing,
- (b) warehousing, and
- (c) transport of excisable commodities.

The arrangements for assessment and collection are generally satisfactory although attended by the usual difficulties arising out of the absence of ability to take decisions at the lower levels of the administration and the non-disposal of appeals. There is scope for economy in the administration especially at factories where the system of control need not be so complex as at a distillery. Recommendations made by an adviser lent by the U. K. Government shortly after the war were apparently not adopted.

Question 122.—Do you agree that a part of the proceeds of excise duties may be earmarked for expenditure on research and development schemes designed to improve the quality and marketability of the commodities?

No direct appropriation for expenditure on research and development schemes should be made from excise duties.

Question 123.—Do you think that the imposition of excise duties has affected adversely the development of industries producing excisable commodities e.g., their size and competitive capacity in export markets?

Excise duties, fixed only by reference to revenue considerations, are too high; use and consumption is correspondingly reduced and the development of industry retarded. So long as the excise is not to be borne by the article to be exported the limiting factor is the export duty or the efficiency of the industry or a combination of both.

Salt Duty.

Question 124.—Would you recommend the re-imposition of the excise duty on salt? If so, on what conditions?

Mahatma Gandhi's objections to the Salt Duty were

- it was not historically an Indian tax but it had been imposed by foreign rulers;
- it was regressive, bearing equally hardly on rich and poor;
- it was levied on a universal necessity.

A tax is not necessarily bad only by reason of its alien derivation; that may be said of other forms of taxation also.

It is true that its incidence was equally imposed on rich and poor. Where the burden of direct taxation is necessarily imposed on a very small section of the population the major part of the revenue must accrue from taxation in its indirect form. It is desirable that every subject should be made conscious of his responsibility to the State and to contribute so far as he can since otherwise the total burden is to be borne only by a few. The incidence of the tax on the individual, no matter how poor, can scarcely be described as oppressive.

Nor is a tax necessarily bad because it is levied on a commodity in general use or because it is unavoidable. On the other hand the duty on salt has the merit that it is particularly simple in its administration since the number of producers is limited and it is inexpensive in collection.

If the duty is re-imposed the recovery of salt should again become a monopoly of the Central Government. There is then assurance for complete control of prices and for the absence of scarcity which has appeared from time to time since the duty was abolished. The individual may be permitted to recover salt free of duty for his personal consumption. Salt for industrial purposes should be free of duty.

Taxes on the Sale & Purchase of Goods and on Advertisements.

Question 125.—Under the Constitution, the only sales or purchases which can be taxed are sales or purchases of goods. Do you consider that the sales tax should be extended to—

- services, so that the tax may be leviable on (a) charges for services proper (e.g., bills from a goldsmith or a printer), (b) charges for both services and goods where the two cannot be readily separated (e.g., hotel bills) and (c) charge for certain types of goods into the price of which service enters as a substantial element (e.g., paintings or photographs); and
- transactions of sale or purchase in stock exchanges and futures markets?

If so, please deal with the administrative and other issues which may arise in the implementation of your suggestions.

In no case should the Sales Tax be extended to services as such. Where the charge for service is a major ingredient of the selling price no Sales Tax should be imposed.

Transactions of sale or purchase in Stock Exchanges should not be subject to tax; transactions in commodity markets or futures markets should be taxed only when the transactions materialise in the transfer of property in goods.

Question 126.—(i) The Union alone has the power to levy a tax on sale of newspapers or on advertisements in them. This power has not, so far, been exercised. Would you propose as desirable and feasible (a) a tax on sales only, or (b) a tax on advertisements only, or (c) a tax on both?

As regards (a), it has been urged that, on account of the small price charged for each newspaper, the sales tax would be fractional and cannot be passed on to the buyers, whereas in the aggregate it would be an undue burden on the concern itself. If you agree with this, how would you meet the difficulty?

As regards (b), what classes, if any, of newspapers or advertisements would you exempt from the tax, and what rates of tax, graded or other, would you levy?

- Have you any suggestions to make regarding the taxation of advertisements other than those appearing in newspapers?

The selling price of a newspaper is generally thought to be less than its cost; the revenue is derived from advertisements of all kinds. A tax on the sale of a newspaper must be recovered through a higher charge for advertising and in effect would be a tax on advertisements. A tax on the dissemination of knowledge is in any event not desirable.

The cost of advertising is an ingredient in the cost of selling the article advertised. A tax on advertisements would therefore be a tax on the cost of selling. In so far as there is already a tax on the goods sold as a result of advertising there should be no tax on a sum spent in effecting the sale. The cost of advertising is included in the selling price of the merchandise; there should be no tax on the components of the price when the tax is levied on the whole.

The foregoing applies equally to other forms of advertising.

Question 127.—As regards sales tax generally and, in particular, the sales tax on goods leviable by the States, it is sometimes argued that—since all goods sold in a State must fall within one of three categories, viz., (a) manufactured or produced within the State, (b) transported into the State from elsewhere in the country and (c) imported into the State from abroad—an extension or increase of excise would serve just as well as sales tax for category (a), of octroi or terminal tax for category (b), and of customs for category (c). Do you agree with this view which implies that the sales tax has no specific function to perform in the country's system of taxation? If not, what in your opinion, from the point of view of a correlated tax-structure, is the legitimate place and scope of the sales tax as distinguished from that of excise, octroi and customs?

The Chamber agrees that the multiplicity of taxes should be reduced wherever possible. It would not, however, be administratively possible to collect an excise on all goods manufactured or produced in the State. Octroi and terminal taxes are a restraint on the free movement of trade and should be abolished rather than increased. The third suggestion can be practicable only in case the first and second are adopted and carried into effect. A properly constructed tax on the sale or purchase of goods is an appropriate means of raising revenue.

Question 128.—(a) Sales tax is almost invariably levied by the State Governments in terms of the turnover of the dealer over a given period. Since a sales tax leviable on the individual transactions necessitates fairly elaborate accounts, cash memos, etc., which only a small proportion of dealers is equipped to maintain, do you agree with the view that, in Indian conditions, the bulk of the sales tax is likely, for a long time to come, to continue to be leviable on aggregate turnover as distinguished from the individual sale-price?

- In most States there are separate laws governing sales tax on petrol. To what articles, if any, do you consider it desirable and feasible to extend the particular system adopted in respect of petrol?

While in present condition it is not easy to levy a tax on individual transactions, sales tax must necessarily be levied on the gross turnover. Regard should however be had for the fact that the imposition of sales tax liability only on a dealer whose gross turnover exceeds a certain limit, creates a certain amount of competitive disability for the registered dealer in relation to the unregistered dealer. The unregistered dealer may reasonably be required to pay a licence fee.

No extension is considered necessary.

Question 129.—(1) In regard to a system of levy based on turnover, is the choice broadly limited to the alternatives hereafter mentioned or is there any other system you would advocate? Under the system you recommend would sales tax continue to be roughly as significant a source of State revenue as at present? The alternatives referred to above are:

- a relatively low rate of levy at each of almost all points of sale; few dealers excluded and few goods exempted (Multi-Point);
- a relatively high rate of levy at only one point, viz., the point at which a registered dealer sells either to a consumer or to an unregistered dealer; exemption from tax of sales by one registered dealer to another registered dealer; exclusion from compulsory registration of a dealer below

a certain limit of turnover; a large number of exempted goods (Single point);

(iii) various combinations of the above.

(2) Which of the above alternatives would you advocate? Please state your reasons in some detail, comparing merits and demerits from the point of view of (a) the consumer, (b) the dealer, (c) industry, trade, etc., generally and (d) Government. Please relate your arguments, as far as possible, to lessons which may be drawn from the actual working of Sales Tax Acts in different States.

(3) In particular:

(i) as regards (a) above, do you think that the sales tax, or any particular form of it, leads to a greater burden being placed on the consumer than is accounted for by the proceeds which accrue to the Exchequer?

(ii) as regards (b) above, have you any suggestions to make regarding the simplification of forms, accounts, etc., and of the procedure generally in order to make the administration of the tax less burdensome to the dealer? Further, having regard to the cost of maintenance of the machinery for compliance, would you suggest an alternative form of taxation so far as small dealers are concerned?

(iii) as regards (c) above, has the imposition of the sales tax led to any noticeable change in the organisation of the trade in the country, especially in regard to the size of the business unit, location of head-offices, number of intermediaries, variety of the goods dealt with, etc.?

(iv) as regards (d) above, please examine the financial and administrative aspects, including the scope for evasion presented by the particular system and the difficulty or otherwise of counteracting it.

A multi-point system is inflationary and is not approved; the tax should be levied only at one point. The rate of tax may be different for different classes of articles according as different income groups are affected. What articles should be exempt from tax altogether is a question independent of the structure of the tax. Articles which are considered essential to the community and accordingly so notified by the Central Government should be completely exempted under State legislation although taxed by the State before the passing of the Central Act. It is again emphasised that the Sales Tax should not be imposed on any goods subject to an excise duty. The incidence of the tax should invariably be at the first point. A combination of the single point and multi-point systems is not approved. From considerations of tax evasion, it would be advantageous to reduce the points of incidence to the lowest possible number.

All raw materials and semi-processed articles which are bought by industrial consumers for purposes of manufacture should be exempt from sales tax at all stages as the cost of these materials will enter into the cost of the finished products which would eventually bear a sales tax on the total cost. On articles manufactured in India or manufactured abroad and imported into India, it is particularly important that the levy should be at the first point of sale.

The rate of tax must be co-related to the ability to pay. If the tax is levied at the first point only, the likelihood of evasion is less since the assesses will be fewer in number and of more substantial status.

The adoption of a single-point levy at the first stage will result in an economy of records and administration.

The diversity of Sales Tax systems throughout the Union has caused a very considerable confusion and the adoption of practices not in the best interests of the economy.

Question 130.—In relation to the particular system you advocate:

(i) should there be special rates of levy, higher than the ordinary rate, for certain articles? If so, for which types of articles?

(ii) should there be special rates of levy, lower than the ordinary rate, for certain articles? If so, for which types of articles?

(iii) which articles, if any, should be exempted altogether and why? Please elaborate the principles which, in your opinion, should underlie exemptions.

All articles declared by the Central Government as essential to the community should be totally exempt from the tax in all States. Other essentials should bear the lowest rate of duty. Semi-luxury should be taxed at higher rates and luxury goods at the highest rate. A tax on essential or near-essential articles such as soap, cloth, sugar, foot-wear and razor-blades would

add substantially to the cost of living of the bulk of the urban population who are bearing more than an equitable share of the taxes at present levied.

Question 131.—In regard to system, rates, exemptions, etc., what degree of uniformity between the different States do you consider desirable and feasible? Would you bring it about—

(i) by formal or informal convention;

(ii) by central legislation promoted at the instance of two or more States;

(iii) by constitutional amendment, so as to include certain basic matters connected with the sales tax in the Concurrent List;

(iv) by constitutional amendment, so as to include the item of sales tax, as a whole, in the Union List? In the last mentioned case how would you apportion the proceeds? Would this alternative be a practicable proposition from the point of view of the finances of the States?

A uniform system of tax should prevail throughout India. Provided essentials are exempted and near-essentials taxed at a lower rate, the rates of tax may also be uniform. A uniformity of system and of rates can only be achieved through Central legislation. The receipts from the tax should be distributed to the States according to their needs.

Question 132.—To what extent has any desirable uniformity been achieved in regard to exemptions (in favour of "goods essential for the life of the community")—under Clause (3) of Article 286 of the Constitution? What principles would you advocate for deciding the exemptions to be made under this provision of the Constitution? Do you consider that the scope of the provision contained in Clause (3) of Article 286 should be extended also to "essential articles" which had been subject to sales tax before the relevant central enactment came into force?

The goods which have been declared as essential under Article 286(3) of the Constitution have in fact been exempted from Sales Tax only to the extent that no additional imposition of tax is permitted without the consent of the President. The tax on these goods existing prior to the Central Government legislation of 1952 continue to be in force, and these taxes varied from State to State. The result is that no uniformity has been achieved. The proper course now is to repeal the taxes currently levied on these articles by the States.

The exemptions presently notified under Article 286(3) of the Constitution may be considered adequate if the rate of tax on near-essentials is as low as possible.

Question 133.—As regards 'sales outside the State', 'inter-State Commerce', etc., please discuss the adequacy or otherwise of the relevant provisions of Article 286 and suggest remedies for any defects which, in your opinion, have been revealed in the actual working of these provisions.

(b) Please discuss in this connection the desirability and feasibility of the suggestion that purchases only (and not sales) should be taxed, so that the tax jurisdiction of each State might be confined to parties residing within the State. Alternatively, do you consider that purchases should be taxed in certain cases and sales in certain others; if so, how and on what considerations would you define the two categories? In either case, please describe your scheme in some detail and explain the advantages which you claim for it.

The majority decision of the Supreme Court has converted, by legal fiction, a large number of transactions, which are essentially of an inter-State character, into intra-State trade subject to sales or purchase tax in the receiving State. As a result all States which have sales tax legislation have taken steps to collect sales tax from sellers outside their respective jurisdiction even in cases where such sellers have no place of business of their own or agent or manager within the taxing State. Consequently a dealer in a State trading with people in several other States is called upon to render accounts to those other States, to submit his books of account for scrutiny and to keep himself fully familiar with the changing regulation and rates in all States. This entails considerable harassment and wasteful expenditure to all such dealers and acts as a restraint on inter-State trade. Further, enforcement requires an elaborate machinery which cannot be wholly effective.

According to the Supreme Court decision, a transaction which is essentially of an inter-State nature becomes one of intra-State nature if, as a direct result of the sale, goods are delivered from State 'A' to State 'B' for consumption in State 'B'. Can the seller in State 'A' or the buyer in State 'B' declare at the time of their transaction *inter se* whether the goods are for consumption within State 'B'? The question can be

answered in the affirmative if the dealer in State 'B' is himself the consumer. However if the dealer in State 'B' is purchasing for purpose of resale, he would not be in a position to say that the goods would eventually be consumed in State 'B'. There are many cities and towns which, by their commercial and geographical position, serve as distribution centres for regions covering more than one State. Dealers in these cities and towns will not really be able to say at the time of their purchases of goods from other States what portion of these goods will be consumed eventually within the State and what portion will be re-exported by them to other States. In such cases are Government going to assume that all goods coming within the State are intended for consumption therein, whereas in fact they will not be so? Whether or not goods are going into consumption within a certain State can only be determined at the point of consumption and not earlier. It is logically wrong to determine the place of sale by what might ultimately happen to the goods after several other transactions. The place of sale must be determined by reference to the sale itself, not by reference to any subsequent transaction. There is also difficulty in interpreting the words "as a direct result of the sale".

The Chamber is of opinion that the Supreme Court decisions show that the provisions of Article 286 of the Constitution have given rise to even greater difficulties than were first envisaged. Sales Tax law must be simple and straightforward for ordinary dealers to understand and implement in their manifold day-to-day transactions. In the interests of simplicity, all transactions which are of an inter-State character should be treated as such; some of them should not be, by legal fiction, converted to intra-State transactions. The imposition of a Sales Tax levied at one and the first point only by the Central Government at uniform rates as recommended by the Chamber will resolve all of the difficulties, disadvantages and inequities implicit in the several questions asked by the Commission. The restraints on inter-State trade will abate in a condition in which there would be only one authority responsible for policy. The tax will be collected from a limited number of generally substantial persons, reducing problems of administration and evasion. The equitable distribution of the proceeds by the Centre will ensure a fair share to those States where by reason of the paucity of original sellers at the first point the revenue from the tax would otherwise be limited.

Question 134.—Do you think that lack of uniformity between the States as regards the rates of sales tax and the methods of applying it (single or multiple point) has the effect of raising barriers in inter-State commerce or of inducing uneconomic diversions of trade? If so, what measures would you suggest to rectify the position?

These questions are already answered.

State Excises.

Question 135.—(a) In regard to State excise duties and the revenue therefrom, have you any comments or suggestions to make—

(i) on features of importance connected with the system of levy of these duties in different States

or

(ii) on policies involving various degrees of relinquishment in certain States of the revenue from these duties?

Should there, in this context, be uniformity between different States? If so, in what particulars and to what extent?

(b) Is there proper co-ordination between the levy of Central excise on medicinal and toilet preparations containing alcohol, etc., and of State excise on alcoholic liquors? If not, what steps would you suggest to ensure adequate co-ordination?

In a condition in which it is not possible in the absence of revenue, to provide education and medical services to a large section of the population even on a minimum standard, a policy involving any degree of relinquishment of revenue from excise must be wrong. Such a policy puts in reverse the maxim attaching merit to doing the greatest good for the greatest number. However that may be, there should at the least be a uniformity of policy throughout the Union. The policy of prohibition cannot possibly be wholly enforced so long as the importing of alcoholic liquors from other States cannot altogether be prevented. If there can be no uniform policy, at the least practice should be uniform and the complexity of restrictions on the inter-State trade in alcoholic liquors removed by an equalisation of excise rates.

General.

Question 136.—Do you think there is a case for vesting in the administration the power to alter, by executive order, the rates of import duties, export duties and excise duties? If so, please indicate in

what circumstances and within what limits such power should be exercised?

There is no case for vesting the Administration with power to alter duties by executive order excepting only in very exceptional circumstances and then only at ministerial level subject to the sanction of Parliament taken at the first opportunity. It is thought that the dangers of the whole system of export duties is implicit in this question.

PART IV.—AGRICULTURAL INCOME-TAX, LAND REVENUE AND IRRIGATION RATES.

Question 139.—A few States levy agricultural income-tax, but in almost none is it among the more important sources of revenue; the progress of land reforms will further reduce its yield. Would you, in order to increase the yield from this tax on for other reasons (which may please be specified), make major modifications in the present system of taxation of agricultural income? If so, please indicate the modifications you would make?

Question 140.—In particular, do your suggestions involve—

(a) correlation, and if so, to what extent, of agricultural with non-agricultural income-tax;

(b) alteration, and if so, in what manner, of the levy of land revenue?

As regards (a), if the correlation suggested takes the form of the levy of a single tax on the total of non-agricultural and agricultural income, instead of the present separate Central and State taxes, please deal with the constitutional, administrative and other problems involved, including the apportioning of proceeds among State Governments. Alternatively, if the State Governments continue separately to levy a tax on agricultural income, but the rates of levy are based on the total of the two types of income, agricultural and non-agricultural, what are the specific problems which arise, and how would you deal with them?

As regards (b), please indicate the probable net effect of the suggested measures on the revenues of Government. What administrative or other issues are involved, and how would you deal with them?

With the progress of land reforms, the abolition of Zamindari and the break-up of large estates, agricultural income-tax is not likely to yield a return commensurate with the cost of assessment and collection unless correlated with non-agricultural income-tax. There is, however, no longer any valid argument for excluding agricultural income from the total income of any assessee provided it is possible to define agricultural income in a simple and equitable manner. One method of determining agricultural income for the purpose of income-tax is discussed under the next question. If income from agriculture so defined is to be included in the general income-tax return of the assessee and income-tax collected on the total income by the present income-tax organization, the non-agricultural income-tax ingredient could be apportioned between Central and State Governments according to the present arrangements for apportionment. It is not possible to assess the probable net effect of the suggested measures on the revenue of Government without a very detailed study of the land revenue records of all the State Governments.

Question 141.—How would you determine taxable income in the comparative absence of accounts in rural areas? What treatment should, in particular, be given to the following:

(i) expenses of cultivation, harvesting, preparation for the market, etc.;

(ii) agricultural losses owing to a calamity or other persons; (In this connection, would you favour giving the assessee the discretion to choose the alternative of averaging his income over a number of years—say 3 to 5 years—in order to cover good and bad years?);

(iii) depreciation in respect of—

(a) live stock,

(b) implements and carts,

(c) means of irrigation, e.g., wells, etc.,

(d) buildings?

The majority of agricultural holdings are so small that even the gross yield from their cultivation would fall well below the present exemption limit for income-tax. The number of assessees on the basis of agricultural income alone must be few, but there may be a considerable number already assessable to income-tax on the basis of non-agricultural income who also have some agricultural income which ought to bear the income-tax. Any method of determining taxable income earned from agricultural operations must fulfil two basic conditions:

(i) it should be possible to determine it on the basis of the existing revenue records;

- (ii) assessment should be related to the potential standard yield of land rather than on the actual yield from each particular plot of land.

If an attempt is made to assess the actual gross return from agricultural operations and to determine the net return after making allowances for expenses of cultivation, harvesting and preparation for the market, as well as for depreciation in respect of livestock, implements and wells, the cost of assessment will be out of all proportion to the expected yield. Further, as it will not be possible to exercise any close supervision in outlying rural areas, there will be far too great a scope for corruption and harassment. On the other hand, if it is possible to calculate the net agricultural return on the basis of the admissible rent that can be collected by a superior holder from an inferior holder (this is usually limited to so many times the land revenue assessment on the land), all the complications of making allowances for expenses are avoided. In most States there is a limit on the rent which the landlord or the superior holder can legally demand and collect from the peasant who actually cultivates the land. Such rent can be taken as a net return on the land, as generally all expenses of cultivation are borne by the actual cultivator. Where land is held in the name of the cultivator himself and no rent is, therefore, paid to a superior holder, the rent that could be demanded by the superior holder, if there were one, may be taken to be the net yield from agricultural operations.

The method suggested here is obviously very crude. If there is to be an aggregation of agricultural and non-agricultural income suitable adjustments will have to be made in every State, taking into consideration the local land revenue system and existing legislation for protection of tenants, under which limits are set to what a superior holder may legally demand from an inferior holder.

Question 142.—What rates would you prescribe for agricultural income tax and how would you graduate them? Is it possible to have uniform rates in all States? What exemption limits would lay down?

The aggregation of agricultural and non-agricultural income for assessment under the Income-tax Act is desirable and accordingly the question of separate rates or their graduation does not arise. Agricultural income would be included in the total assessable income and would automatically be subject to uniform rates in all States.

Question 143.—For areas already under or likely hereafter to be brought under ryotwari or similar tenures, do you consider that land revenue policy should be based on some form of periodical settlement?

If not, what alternative would you suggest? How would you work it? What would be its probable net effect on Government's revenues?

With the steady rise in the prices of agricultural produce over the last 14 years, land revenue is no longer a very heavy charge on the cultivator. In principle, however, it would not be equitable to ignore long-term changes in either the fertility of the land or in other factors like access to markets. There is, therefore, a case for periodical settlement. But with the decreasing importance of land revenue in the nation's budget, it is no longer necessary for such settlements to be as elaborate as the original settlements. Adjustments in the existing rates of revenue should be made only when there are major factors increasing or diminishing potential income of the farmer in the areas covered by such settlements.

Question 144.—If you are in favour of periodical settlements, what modifications, if any, would you make in the practices and principles which have been followed hitherto, and why? In your reply, please refer in particular to the following—

- (i) **Period of guarantee.**—Should this be shorter than in the past? Would you suggest longer periods in special circumstances, e.g., when ryotwari tenure is introduced for the first time?
- (ii) **Scope of guarantee.**—Should a fixed assessment be guaranteed for specific piece of land (or for a proprietary body, as for instance, in the Punjab)? Alternatively, should a basic rate be fixed and limits guaranteed within which it may vary? What factors would you take into account in varying the rate, e.g., area, nature of crop, yield, prices, etc.?
- (iii) **Basis of assessment.**—How should the basic rate be fixed? Would you introduce an element of progression?
- (iv) **Incentive to production.**—Would it be feasible so to regulate assessment as to provide an incentive for—
 - (a) larger agricultural production?

- (b) shifts in production, e.g., from cash crops to food crops or vice versa?

- (c) capital improvements to land?

- (v) **Payment in kind.**—Would it be possible to provide for payment in kind either partially or in full? Please discuss the advantages, difficulties, etc.

- (vi) **Uniformity between States.**—In the application of these principles what degree of uniformity between different States would be desirable and possible?

Question 145.—In regard to a re-settlement as distinguished from an original settlement, what additional principles, if any, would you suggest?

Account must be taken of existing settlements and principles of revenue collection in different States. It would be obviously impossible, politically, to effect any major changes to the detriment of the cultivator who has always regarded his land and everything associated with it as stable and constant. There is only a very limited scope for alterations and improvements in this connection and it is not possible to introduce any broad, general reasoning.

Question 146.—Where re-settlement is overdue but cannot yet, for administrative or other reasons, be undertaken, what transitional steps would you recommend in order to bring the old rates into conformity with changed conditions?

Would you levy a surcharge on the old rates, graduated if need be with reference to such factors as crop grown, size of holding, etc.?

How would you provide against the possibility of such a surcharge accentuating the disparity already present as a result of settlements of different areas having been undertaken at different times?

If the existing disparity is itself of a significant degree, what steps would you take to reduce it?

It would be politically unworkable to levy any surcharge on land revenue in the absence of resettlements. Where conditions have changed so materially as to result in a significant degree of disparity between neighbouring areas, a resettlement should be undertaken as expeditiously as possible. Short-term measures will be unworkable unless there is a proper resettlement.

Question 147.—Since a certain degree of disparity may be present—

- (i) between the pre-existing and the newly merged areas of a Part A State; or
- (ii) between the different units which have gone to form a Part B State;

What steps, if any, would you take, pending a general resettlement of such areas, towards removal or reduction of disparity?

The cultivator, in whatever State or area, considers his tenure and conditions of farming to be one of the most stable and constant factors in his environment. Any administrative action, in the absence of a resettlement, undertaken with a view to remove disparities between adjoining areas in Part "A" States and Part "B" States, will therefore be politically unworkable.

Question 151.—Are there any suggestions which you would make in regard to the assessment of—

- (i) agricultural land in rural areas, used for non-agricultural purposes;
- (ii) land classed as agricultural but now part of an urban area and used for non-agricultural purposes; and
- (iii) land classed as non-agricultural, whether in rural areas or in urban areas, and used for non-agricultural purposes?

It is now a recognised principle in most States that land used for non-agricultural purposes should bear a heavier revenue than land used for agricultural purposes. The equity of this principle has not been questioned seriously and it should be extended to all non-agricultural use regardless of the original classification of the land as agricultural or non-agricultural.

Irrigation Rates & Betterment Levy.

Question 155.—Would you recommend any of the following taxes, either singly or in combination, where a major irrigation work has been constructed by the State—

- (i) a betterment levy representing a portion of the increase in the value of land;
- (ii) an irrigation rate for the water actually supplied;
- (iii) a small compulsory cess for all lands under command whether the water is actually utilised or not;
- (iv) any other tax or taxes, as an alternative to or in conjunction with the above?

Where a major irrigation work has been constructed by the State, there is every justification for both a

betterment levy representing a portion of the increase in the value of the land, so long as that is imposed only upon a sale when the actual cash value of the betterment is determined, as well as an irrigation rate for the water actually supplied. There is also every justification for a small compulsory cess for all lands under command, as any landholder entitled to use water should contribute in some measure for its availability whether or not he chooses to make use of it. Such compulsory cess should however, be a very small charge by comparison with the irrigation rate for water actually supplied.

Question 156.—What portion of the increment in land value may be reasonably absorbed by the State as betterment levy?

How should it be assessed, in what instalments should it be collected and by what administrative machinery?

How would you time the recovery in relation to development, i.e., before the project comes into full operation or afterwards when substantial incremental value is actually realised?

Would it be proper and practicable to impose a betterment levy on lands already benefited by an existing irrigation work?

Should the proceeds from the levy be earmarked for a specific connected purpose, e.g., contributing towards the cost of the particular irrigation project or of other irrigation projects?

With so many alternative irrigation projects under consideration, landholders in areas fortunate enough to receive priority for construction should have no cause to complain if as much as 50 per cent. of the increased value of their lands is absorbed by the State by way of a betterment levy provided that the levy is collected only at the time of sale of holdings.

The provision of irrigation facilities makes such an enormous difference in the value of the land and the potential standard of living of the landholder that there is every justification for a betterment levy. The assessment and collection of the levy however, must present very serious administrative problems. The simplest method of collection might be one which comes into operation at the time of transfer of the improved land-holding by sale. It should be relatively easy to determine the difference between the value at the time of the last sale and sales effected after the provision of irrigation facilities. To some extent, this method can yield certain revenue even before a project comes into full operation as land values will appreciate in anticipation.

Further appreciation, that is appreciation after the first sale following on construction of the project, presents a more difficult problem; the same land should not be subjected to a second betterment levy unless it is possible to devise a method of assessing further automatic improvements in the value of holdings unconnected with the efforts of the landholder.

If the proposal to realise betterment levies by a charge at the time of registering subsequent sales of land is accepted, it will not be difficult to impose a betterment levy on lands already benefited by an existing irrigation work provided it is possible to estimate the standard improvement in land values in the area.

In no progressive system of taxation can receipts be directly linked with expenditure for specified purposes.

Question 157.—(i) Should the irrigation rate be no more than an adequate charge for the water supplied or should it also contain an element of additional levy on the increased yield or crops? Can you indicate with reference to conditions in your State whether, and if so to what extent, there is an element of additional levy in respect of (a) old irrigation works (b) new irrigation works? What limits would you place on the quantum of additional levy in respect of (a) old irrigation works (b) new irrigation works?

(ii) Would you base the irrigation rate primarily on (a) area irrigated, (b) quantity of water supplied, (c) crop value, (d) any other factor?

(iii) Are you in favour of periodical revision of water rates? If so, with reference to one or more specified States, what period would you consider appropriate in conformity with economic considerations and in the light of administrative convenience?

(iv) Do you advocate concessional or incentive rates particularly in the initial stages of development, with a view to encouraging the production of specific crops or the adoption of desired farming techniques?

The benefit normally derived from the provision of irrigation facilities is so great that there is every justification for inclusion in the irrigation rate of an element of additional levy on the increased yield of crops. The irrigation rate could, in fairness, be assessed so as to be in the same proportion to estimated value of the

standard yield as land revenue to estimated yield on unirrigated land.

The irrigation rate should be based primarily on the quantity of water supplied; the landholder who, by utilising a given quantity of water to better purpose, is able to secure a higher crop value than his neighbour should not be penalized.

Water rates once determined should not be revised too frequently. In general, the same consideration should determine the revision of water rates as determined resettlements affecting revision of land revenue.

It is not desirable to complicate assessment of water rates by introducing concessional or incentive rates for particular crops or farming techniques. The necessary incentive in this respect is best provided directly by offering a better price for specific crops and educating the farmer who will learn that a better economic return results from the use of improved techniques.

Question 158.—How would you fix the compulsory irrigation cess? Would you make it a small fee relatable to the annual cost of maintenance of the work?

Landholders are likely to accept compulsory irrigation cess more easily if they appreciate that it is related to the annual cost of maintenance of the work.

Question 159.—If the items mentioned above—betterment levy, irrigation rate and irrigation cess—were discussed in connection with a minor irrigation work, or a tube well scheme, to what extent would your replies have to be modified?

What has been said of betterment levy, irrigation rate and irrigation cess applies with equal force to minor irrigation works or tubewell schemes as the landholder benefits appreciably from investment by the State. He should, therefore, be prepared to contribute towards the cost of such work and towards extension of similar works to other less fortunate areas.

Question 160.—In what circumstances would a consolidated rate of land revenue—where the assessment includes an element of water rate—be preferable to a scheme of separate irrigation rates and cesses?

A consolidated rate of land revenue including an element of water rate is not practicable as it will not be possible to assure constant and adequate supply of water to every landholder in the area; the element of water rate must have some relation to the quantity of water supplied.

Question 161.—What is the scope for the imposition of a surcharge on irrigation rates based on—

- (i) crop values;
- (ii) sizes of holdings, etc.,

for the purpose of financing projects of a local character?

Land covered by irrigation schemes can obviously bear a higher local cess than dry lands. If local cess is to be determined as a proportion of land revenue, it will be only fair to assess local cess on irrigated lands after adding irrigation rates to the land revenue. If the local cess is based on annual value, irrigated land will automatically bear a higher cess as it will have a higher annual value than dry land.

PART V.—OTHER TAXES (Central and State).

Stamp Duties and Court Fees.

Question 162.—Under the constitution—

- (1) the Union is empowered to fix the rates of stamp duties in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts, and
- (2) the States are empowered to fix the rates of all other stamp duties.

As regards both (1) and (2), have you any suggestions to make for the levy of a stamp duty where it is not already levied, or for an increase or decrease of the present rates where a stamp duty already exists? Please give reasons for your suggestions. Are there any general principles which you would propose for adoption in regard to the fixation of rates of stamp duties?

As regards (2), since the rates vary from State to State, what degree of uniformity do you consider desirable and feasible, and how do you propose to achieve it?

If possible, please estimate the net effect of your proposals on the revenues of States.

The present duties on commercial documents are high enough. The duty on cheques payable until 1927 was thought to impede the development of banking and was accordingly withdrawn. It is now more than ever important that the banking habit be encouraged

and money concentrated where it will be productively employed. The duty on cheques should accordingly not be re-imposed. As with other duties and taxes there should be uniformity throughout the Union if only for the sake of simplicity. The Stamp Act is a most complex piece of legislation.

Question 163.—*Certain States (e.g., Bombay) levy stamp duties on transactions in forward markets. What is your view regarding the complaint that these duties have tended to affect the business in these markets, particularly that of the middle class traders? If you consider that the levy of stamp duty on transactions in these markets is a suitable and potentially important means of securing revenue, what administrative and other measures would you suggest for the efficient collection of such duties? Alternatively, in place of stamp duties, would you suggest some other form of taxation of transactions in stock exchanges and futures markets? If so, please elaborate your suggestion.*

A contract for the ready purchase and sale of any commodity attracts no tax or duty of the kind contemplated by the question although there may be an increment to the price by way of Sales Tax. Any such tax or duty would operate as a restraint on the movement of commodities and on trade generally. So much can with equal force be said of the forward contract made as a form of insurance indispensable to all traders in or users of commodities. If it were possible to distinguish between the genuine hedge and the speculative contract the latter should be heavily taxed; but there seems to be no means of identifying the speculative contract excepting only that in shares in the case of which a speculative transaction may be presumed if there is no delivery.

Question 164.—*In this country, the stamp duty is ordinarily a tax on documents which constitute evidence of legal rights. There are, however, certain taxes, such as the entertainments tax, which are sometimes collected in the form of stamps, and suggestions have been made that this system may be appropriately extended to the collection of taxes on the sale of goods or on other transactions. Do you agree with this view? If so, to what taxes would you extend the scheme?*

The utmost economy in collection is desirable but it is extremely doubtful whether it would be practicable to substitute a stamp duty for the tax on a sale of goods in its present form if the facility for evasion is not thereby to be increased.

Question 165.—*What are the more common methods of evasion or avoidance of payment of stamp duty? What means of prevention would you suggest?*

There is a substantial loss in the revenue from stamp duties in a condition in which—

- the transmission of a share is possible without evidence of probate or letters of administration;
- it is the custom to hold shares on blank transfers;
- the stamp duty on a transfer of shares is paid by adhesive label.

It is commonly provided by Airticles of Association of companies that the directors may in their absolute discretion dispense with the production of probate or letters of administration or such other legal representation by the person claiming title to the shares of a deceased member of the company. There is substantial avoidance of probate duties as a result. It is important that the avoidance be checked. It may at the same time be noticed that avoidance of the probate duty will continue to be possible so long as the obligations proposed to be imposed by the Estate Duty Bill may be discharged without an application for probate or letters of administration. In the result there will be a diversion of revenue from the States to the Centre.

It is doubtful whether the practice of abstaining from securing the registration of shares has appreciably abated since the Bombay High Court held in *Shri Sakti Mills Ltd. v. Commissioner of Income-tax* (reported at 1948, I.T.R. 187) that credit under section 18(5) of the Income-tax Act for the tax paid by the company could be claimed only by the person registered as the holder of the shares. The payment of the stamp duties on the transfer is avoided if the shares are held under a deed of transfer executed only by the transferor to the extent that the property in the shares may pass through a number of hands without the registration of any transfer and it may be observed that certain banks customarily make advances upon the pledge of such shares without requiring their registration either in the name of the bank or in the name of pledger. No stock or share may be sold under sanction of the rules of the London Stock Exchange unless registered in the name of the vendor. There can be no escape from payment of the duties on the transfer. The enforcement of that rule is rendered practicable by arrangements for securing the completion of transfer within the shortest possi-

ble time believed to be 48 hours at the most. In India the time taken for the completion of a transfer of shares extends to three months or more. It may not be practicable in India to adopt the English law and practice; the evasion of the payment of stamp duties on transfers of stocks and shares may, however, be substantially abated if the banks are prohibited from making an advance upon the pledge of stocks or shares not registered in the name of the pledger or in the name of the bank or its nominees.

Even if cancelled as by an indelible rubber stamp at the time a transfer is approved the adhesive label by which the stamp duty on a transfer of shares is paid is easily removed and used a second time. The label does not carry the date of its issue as does the impressed label. It is believed that a substantial evasion of duty derives from the use of the adhesive label and that the revenue would advantage if the stamp duty on a transfer of share were to be paid by impressed label.

Question 166.—*The rates of court fees differ from State to State. To what extent do you consider uniformity in the rates desirable and feasible?*

Question 167.—*Have you any suggestions to make regarding the schedules to the Indian Court Fees Act and the rates of levy thereunder?*

Uniformity throughout the Union is certainly desirable.

Taxes on Motor and other Vehicles.

Question 168.—*Taking into account (a) the several taxes, Central, State and Local, which affect motor transport directly and business, trade, etc., indirectly, (b) the variation in some of these taxes from region to region and between different categories of vehicles, and (c) the relative financial needs of the different taxing authorities, both generally and, in particular, for the maintenance, improvement and extension of roads, what changes, if any, would you introduce in the present system of motor vehicles taxation? What degree of uniformity do your suggestions involve? Instead of several taxes by different authorities, a consolidated tax has been suggested: do you consider this feasible? How would you apportion the proceeds among the different authorities concerned?*

Taxes on vehicles are a tax on transport and are accordingly an indirect levy on the goods, commodities or persons taxed. The cost of transport including the taxes levied on it directly affect the cost of living, the health, the education and well-being of every one of the nation's crores of citizens.

The present inadequacy of transport facilities is a serious restraint on development and prevents the raising of living standards. In many regions road or rail transport is non-existent or roads are so poor that transportation costs are prohibitive. Production is accordingly equated to local consumption for want of cheap transport to consumers in other areas. The fishing industry, for example, is undeveloped because markets remote from the coast cannot be quickly reached; fruit is left to rot or is used as manure since there is no cheap and efficient transport to carry it to other parts of the sub-continent.

It is essential that all transport including motor transport and its taxation be placed under the direct control of the Central Government. The present condition in which there is a multiplicity of authorities should be changed and the right to impose taxation vested only at the Centre. Railways, air services and shipping are already so co-ordinated and controlled; they do not suffer a tax of the same character as the taxation on other forms of transport. Charges made by the docks and air-ports for facilities provided are not taxation according to any concept. Transport by motor vehicles being equally essential should have the same treatment. If the sole right to tax motor transport is vested in the Centre there will be complete uniformity.

A consolidated tax imposed at the Centre would present no unusual difficulties. The several States or municipalities could be made responsible for its collection and the preparation of the statistical data necessary for its allocation.

Question 169.—*To what extent and in what manner, in your view, should the proceeds from motor vehicles taxation be earmarked for road maintenance and development?*

The proceeds of a consolidated tax on motor vehicles levied at the Centre should be used in part as a subvention to the States, municipalities and other local authorities out of which to maintain roads within their jurisdiction not the responsibility of the Centre, and in part be appropriated to a non-lapsing road Fund to be expended on the construction and maintenance of roads over the whole country by a system of broad priorities. The need for a central organisation such as the Bureau of Public Roads in the U.S.A. or the Indian Railway Board is indicated. With it should be incor-

porated the Roads organisation of the Ministry of Transport. The construction of new roads cannot, however, be financed entirely from revenue but part of the cost must be financed by borrowings.

Question 170.—Have you any specific comments to make on the main recommendations of the Motor Vehicles Taxation Enquiry Committee, 1950?

The Chamber approves the rates of tax proposed by the Motor Vehicles Taxation Enquiry Committee, 1950 but is of opinion that its control and administration is better vested in the Union Government and further that—

(a) in the altered conditions in the automobile industry all motor vehicles and their components should be exempt from the Sales Tax;

(b) the fuel tax should be at a uniform rate of 6 annas per gallon of motor spirit on which there should be no Sales Tax.

Question 171.—Have you any suggestions to make regarding the extension of taxation to, or increase of present taxation on, users of roads other than motor vehicles? How would you classify the users, what rates would you suggest and who, in your view, should be the taxing authorities? How would you dispose of the proceeds?

All animal-drawn vehicles should be taxed subject to an abatement if fitted with rubber tyres. The tax would then be more appropriately described as a Roads Tax rather than a Motor Vehicles Tax.

Entertainments Tax.

Question 172.—This tax is usually levied on tickets of admission to entertainments or amusements, of which the cinema is by far the most important. In this regard, the Cinematograph Industry Enquiry Committee considered the incidence of the tax on the industry too heavy. Do you agree with this view and, in particular, do you consider that the rates have reached the point of diminishing returns?

The Committee also suggested uniformity in the rates of duty which differ widely from State to State. Do you agree with this view? If so, how should it be achieved?

How far would you apply graduation in the rates of entertainments tax?

What modification in the system of levy would you suggest?

The tax may be judged to be too heavy if in the result the cost of a desirable form of entertainment is beyond the means of a large section of the population and an important industry suffers or, from the revenue angle, the law of diminishing returns operates so as to reduce receipts. It is generally reported that the receipts from the tax have declined and accordingly there may be a presumption that the tax is too heavy.

A uniformity of charge throughout the Union is always, in principle, desirable. The tax should be graduated with exemption at the bottom of the scale. The present system of levy is considered satisfactory.

Question 173.—What principles would you adopt in regard to exemptions? Should the criterion be:

- (i) character of the entertainment (e.g., educational film);
- (ii) nature of object to which net receipts are applied, (e.g., charity show);
- (iii) class of persons admitted to entertainment (e.g., lowest class of ticket);
- (iv) any other factor?

The exhibition of educational films should be exempt.

Question 174.—How important is evasion of the entertainments tax and what methods of evasion are practiced? What steps would you take to minimise evasion? Should there be a restriction on the number or proportion of complimentary tickets issued? Should collection be more generally by stamps?

According to reliable information, evasion is not extensively practiced: the present system of inspection is adequate for its detection. The practice of allowing reputable exhibitors to pay weekly in arrears should continue.

Question 175.—Would you suggest the extension of the scope of application of the tax to any other organised and conveniently taxable forms of entertainment not taxed at present? Would you recommend the exclusion from the scope of the tax of any kind of entertainment which is taxed at present?

The Chamber has no comments.

Tax on the Consumption or Sale of Electricity.

Question 176.—A tax on the consumption or sale of electricity is levied in several States in India. Do you consider that this is a suitable tax and may be adopted by other States? Would you restrict it to consumers of energy for domestic purposes or would you extend it to sales for industrial uses also?

Electrical energy is pre-requisite to almost every form of productive activity and accordingly its generation and distribution is one of the major objectives of the Five-year Plan. A tax or duty imposed at its very source must operate as an impediment to productivity and should find no place in a healthy tax structure. The national income will increase in direct ratio as the employment of electrical energy in agriculture and industry; the State will advantage by the larger revenue from direct taxation in the form of income-tax and from indirect taxation on the increase in consumption resulting from improved living standards.

There is no better case for the tax or duty on electrical energy used for domestic purposes. It is both literally and figuratively a source of light and is an essential and important element in the modern standard of living. The tax discourages its universal application and tends to deny its benefits to persons not far removed from the subsistence level. It should be the policy of the State to make electrical energy as cheap as possible.

Question 177.—In respect of domestic purposes—

(a) should a distinction be drawn between the electrical energy consumed for light and fans and the energy consumed for other domestic purposes (frigidaires, heaters, radios, etc.)? On what principles would you determine the rates of duty?

(b) what exemptions would you suggest and on what basis? Would you apply a lower rate of duty to small consumers?

If at all a tax or duty is imposed on electrical energy used for domestic purposes no distinction is practicable between classes of domestic consumption without introducing the need for a separate and expensive wiring system. Any tax or duty should be levied as a percentage of the selling price, and applied without distinction as to the domestic use to which it is put.

Question 178.—If you are in favour of a duty on energy used for industrial purposes, on what principles would you determine the rates of duty? What exemptions would you provide for and on what basis?

The Chamber is opposed to any tax or duty on electrical energy for whatever purpose used. Any tax or duty imposed notwithstanding should not exceed the lowest rate of tax levied by the State upon the sale of an essential commodity and there should be an exemption in favour of any industry in which the cost of the energy exceeds 10 per cent. of the prime cost of production.

Question 179.—How would you modify your suggestions in reply to the foregoing questions if electrical energy—

(i) is entirely supplied by Government undertakings in a State,

(ii) is supplied by Government undertakings in some areas of a State, and private undertakings in other areas?

The objection is taken to a tax or duty on electrical energy primarily because it must operate as an impediment to productivity. That objection lies whether the energy is supplied by the State or by private enterprise.

Question 180.—What degree of uniformity as between different States would be desirable in regard to the levy of electricity duty? How would you achieve it?

Any tax or duty must be uniform throughout all States in the Union if the tax burden is to be equitably distributed and one industrial unit is not to be placed at an advantage over another merely by reason of its situation. Power to impose the tax or duty should vest in the Union, not in the State.

PART VI.—LOCAL TAXATION

In dealing with this part of the Questionnaire, the Chamber confines itself to a few observations on octroi and terminal taxes.

Article 301 of the Constitution provides that trade, commerce and intercourse throughout the territory of India shall be free. Do octroi and terminal taxes not in effect set up internal frontiers and create barriers to be opened to the passage of goods only upon payment? Their levy may not be 'ultra vires' the Constitution according to the letter of the law; but the good intentions of the Constitution-making body are at the least frustrated.

Any tax or duty which bears on the raw materials of industry or on goods carried by road merely by reason of their being so carried is bad for it increases the cost of production and of motor transport with consequent discouragement to road development.

In line with its proposals for a reduction in the

multiplicity of taxing authorities and for a uniformity of tax rates throughout the Union, the Chamber is of opinion that the authority to levy these taxes should be repealed and that local authorities be compensated for their loss by a subvention from a tax on consumption, viz., the Sales Tax.

VIEWS OF THE BOMBAY CHAMBER OF COMMERCE SUPPLEMENTARY TO THEIR REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

Copy of letter, dated 8th October 1953 from Secretary of the Chamber to the Secretary Taxation Enquiry Commission.

"My Committee's submission made in reply to the Questionnaire is now in your hands. My Committee desire me, however, to direct your attention to these matters which they consider to be of particular importance, namely

- (a) the need for a reduction in the multiplicity of taxing authorities and a uniform system of taxation throughout the Union at equal rates;
- (b) the proposal made for the inclusion of agricultural income aggregately with other income under the Indian Income-tax Act;
- (c) the need for better definition of the status of the corporation-tax;
- (d) the significance of the frequency of questions put concerning the assessment and collection of income-tax;
- (e) the private company's status in the economy;
- (f) the administration's disregard of the procedure prescribed at section 30 of the Sea Customs Act and failure to create the arbitral machinery agreed to be set up under Article X of the General Agreement on Trade and Tariffs;
- (g) the proposal made for the re-imposition of the Salt Duty.

2. My Committee are not unmindful of the valid considerations for which the States were given so substantial a degree of autonomous government and so wide a field for the raising of revenue; nor are they unaware of the significance of any proposal for constitutional modification of the powers presently enjoyed by the States. The experience of trade and industry during the last few years, however, suggests urgent need for such modification and a larger vesting of control at the Centre so that not only the incidence of a tax but also the regulating statutory provisions are uniform throughout the Union.

3. My Committee believe the proposal to extend the scope of the Income-tax Act to agricultural incomes is generally approved and needs little emphasis.

4. Nothing has been done since the Todhunter Committee reported in 1925 to clarify the position of the corporation-tax. Its double incidence on the shareholder-corporation is a long-standing grievance which merits serious consideration. My Committee are of opinion that it would be logical to treat the corporation-tax as an additional duty of income-tax as it is described at section 55 of the Act and to credit it as tax paid on behalf of the shareholder after inclusion in his income. My Committee's views are set out at some length in the submissions made by way of reply to the questions put at Part II of the Questionnaire.

5. A significant feature of the Income-tax section of the Questionnaire is the emphasis on evasion, the recovery of arrears and, in perhaps less degree, the relations between the Department and the tax-payer and procedural delays.

6. My Committee will support any proposal designed to check evasion and to recover the tax so long as the liberty of the subject is not thereby endangered and the measure proposed does not carry with it increased opportunity for corruption. They observe, however that the Legislature has strengthened the administration in a number of ways during the last fourteen years. The period of limitation for the institution of an assessment or for re-assessment has been extended and the impediment implicit in the pre-requisite discovery of information removed; the scheme for advance payments and the power to make a provisional assessment has been introduced; the power of indirect recovery has been established; The power to make a summary assessment and to issue a demand payable within twenty-four hours has always been a feature of the statute. A number of the questions asked appear to suggest that the executive must have still more powers if the Act is to be effectively administered.

7. My Committee understand that some 26 crores of rupees of income-tax are in arrears; in addition sums due under assessments made by the Investigation Commission are to be recovered over a long period of years by an unwarranted liberality of instalments. According to the Department this unsatisfactory situation derives from a

shortage of executive staff. Persons closely associated with the work of the Department, however, observe with grave concern its reduced output attributable, in their opinion, to a growing deterioration and demoralisation of the administration. The Income-tax Officer is not always the sinister character he is reported to be but his future prospects may on the one hand depend upon the exercise of diligence to the point of harassment as evidenced by the assessment record and, on the other, upon an abstention from diligence in favour of a particular assessee at the instruction of his superior. In such a condition there can be no loyalty, no 'esprit de corps'. Government must enjoin upon the senior officials of the Department the need to observe an unimpeachable code of conduct in their relations with the public and should, in particular, express its disapproval in case there is a close association with persons of substantial means and ill-repute.

8. My Committee have noted with disapproval and some concern references recently made in a certain place to the private company; it has been said it is bogus, being in reality a partnership in disguise, and should be taxed as an association of persons. These references are apparently inspired by the default of a number of private companies whose assets have been alienated before income-tax assessments have been discharged; it is in any event to be seen whether action for assessment and recovery was taken in time.

9. In advanced countries, the private company is the rule, not the exception. In India, constitution as a partnership may be preferred, not always to avoid the charge of corporation-tax but frequently, with notable exceptions, because of the potential for evasion implicit in the unregistered partnership in a condition in which registration under the Partnership Act is permissive, not mandatory, and the power of assessment as a registered partnership can be exercised only if the partners are known.

10. The private company is frequently the public company in embryo and it derives from the facility with which a number of persons may join together for the promotion of a business or industrial enterprise. The members of such a company are no less entitled to the benefits of incorporation, including the development of capital through profit retention, than are the members of a company so entitled merely because of its larger membership.

11. The difficulties accruing from the disparities between the Customs Tariff and the Import Trade Control Schedule and official non-observance of the provisions of section 30 of the Sea Customs Act are in themselves serious enough. The absence of a quasi-judicial arbitral machinery for the resolving of disputes and the hearing of appeals is a matter of much concern; it is hoped the Commission will take particular notice of Government's failure to implement the provisions of Article X of GATT to which a reference is included in the submission made in reply to Question 112.

12. My Committee's submission throughout emphasises the importance of the indirect tax in a condition in which only so small a number are able to contribute directly to revenue. At one or more points attention is directed to the relative prosperity of labour, both urban and rural, and the poorer condition of the middle classes especially the lower middle class. Even the latter, however, are not so poor that they would be greatly affected by a re-imposition of the Salt-Duty. Only the very poor are likely to be affected but it is thought its incidence is not likely to be oppressive even on the poorest; in the alternative some means for the abatement of its incidence may be devised.

13. The Committee will look forward to the issue of your report with the keenest interest."

Copy of letter, dated 23rd September 1954, from the Secretary of the Bombay Chamber of Commerce to the Secretary, Taxation Enquiry Commission.

Commission's Note on "Sales Tax".

"When representatives of the Chamber gave oral evidence before the Commission on 8th February this year, the Chairman said he would send to the Chamber for its comments a note on "Sale Tax" containing certain tentative proposals to overcome the present difficulties experienced by non-resident dealers in the matter of inter-State Sales Tax.

Nothing further was heard from the Commission, but a copy of the Note sent by the Commission to the Bengal Chamber of Commerce was forwarded to this office by the Associated Chambers of Commerce, Calcutta. The Committee of the Chamber have considered this Note and they have the following comments to make on the proposals contained therein. The Committee hope that their views will be given due consideration by the Commission in formulating their final recommendations to Government.

At the outset I have been asked to make it clear that the Committee do not accept the lists of articles enumerated in the Commission's Scheme as exhaustive. These lists, have to be considered rather carefully, and I have been asked to emphasize that my Committee have not done so at this stage as they consider the whole Scheme to be far from practicable. The Committee's detailed comments on the Note are as under:—

Recommendation 1.—It is not clear from the recommendation whether the prohibition of imposition of Sales Tax would be only on the exporting State. In our view the articles enumerated in this recommendation are all essential to the life of the community and should be free from Sales Tax at any stage in any State.

It appears that the recommendation is only limited to prohibition of tax by the exporting State, as recommendation No. 6 deals with certain articles which should be free from all Sales Tax. As stated earlier, we are against a tax being levied on these articles even in the importing States. In fact, in most States these articles are even to day free from any Sales Tax.

Recommendation 2.—This recommendation implies that industrial raw materials will have to bear some Sales Tax although the total incidence of tax is sought to be limited by a ceiling. We reiterate the view set out in our memorandum to the Commission, viz., that raw materials should be entirely free of tax, for the reason that the finished products will be available for taxation.

Further, assuming that these articles have to bear some tax in the present context of National economy, it is not clear how the ceiling is going to be enforced without substantial Central intervention and regulation of the taxing machinery. If the ceiling is to be imposed, there has to be a statutory prohibition, which means amending the Constitution in a material manner. Moreover, goods of this kind on sale in any one province may have emanated from more than one State, each of which will have its own rates of tax. The tax levied in the receiving State will depend on how much has already been charged by the exporting States. This implies that the dealer in the receiving State will have to keep himself abreast of the rates of taxation in all the exporting States and will have to keep his accounts in such a manner as to show from what State he has received his stock. Further, these goods having once come into a particular State, will pass from the importing dealer to other dealers, and it will be extremely difficult to trace the origin of each lot. In short, if a ceiling has to be enforced, it can only be effectively done by limiting the imposition of tax to one stage. A multi-point tax system does not suit the proposal.

The proposal also implies that the same transaction may be subject to a tax in the exporting State and a tax in the importing State, which is against the spirit of Article 286 of the Constitution. Moreover, this does not solve the problem as to who is to pay the tax in the importing State, whether it should be the dealer in the exporting State, or the dealer or the consumer in the receiving State.

We therefore emphasise that insofar as Central intervention is inevitable under the proposed Scheme and the taxation structure envisaged is a single-point one, the tax might as well be levied by the Centre.

Recommendation 3.—This proposal also implies amendment of the Constitution—

- (a) so as to empower the exporting State to levy, a tax, and
- (b) to limit the power of the exporting State to a particular ceiling.

Further, it also implies Central Government intervention and the possibility of taxation of the same transaction in the exporting State and in the importing State. The problem of "who is to pay the tax in the importing State" still remains unresolved. If the exporting State, within whose jurisdiction the specified articles are manufactured, should be given some revenue, the proper way of doing that would be to give an allocation from the

Sales tax revenue on inter-State trade to be collected by the Central Government according to our proposal, at the rate of three pies in the rupee on goods exported from the manufacturing State. We are of the opinion that since largescale Central intervention and amendments of the Constitution are necessary, this might as well be done by the Centre to simplify the whole structure of taxation, leaving the question of allocation of revenue to the different States to be decided periodically by a suitable machinery.

Recommendation 4.—This proposal contemplates the exclusion of the enumerated articles from any tax in the exporting or importing States so far as inter-State movements are concerned. Further it also contemplates a single-point tax at the stage of sale to the consumer or, presumably, to the unregistered dealer. Once the desirability of a single-point tax is conceded in regard to a wide variety of articles classified as 'Luxury goods', there should be less reason for retaining a contrary structure, i.e., multi-point, in regard to articles of necessity. We therefore again stress that a single-point tax system is the most suitable and that, in any case, this system has the widest acceptance among the States.

This proposal also contemplates amendment of the Constitution so as to limit the power of the States to a particular ceiling.

Recommendation 5.—In the event of an export tax becoming permissible, we agree that such a tax should not be levied where there is no tax on internal consumption. However, as stated earlier, we are against the levy of an export tax by the exporting State.

Recommendation 6.—We do not think that the articles which should be free from all sales tax at all stages in any State should be limited to agricultural implements worked by human or animal power. As already stated with reference to our comment on Recommendation (1), there are many other articles which should receive the same treatment.

Recommendation 7.—We have already stated earlier that a multi-point tax system is not suitable.

General.—The Committee would like to draw the particular attention of the Commission to the fact that the Central Government have so far refrained from intervening in the rights of State Governments to administer their own sales tax laws in the best way suited to their financial requirements. The Scheme envisaged in the Commission's Note, however, cannot be implemented without substantial intervention by the Centre in the matter of fixing the suggested ceilings and amending the Constitution so as to empower the exporting State to levy a tax on the goods exported out of the State. In view of this, the Committee consider that the scheme would not find favour with the States and they would therefore, reiterate that the following proposals, which they have already submitted to the Commission in their Memorandum, should be given due consideration as being the next best alternative solution to the problem:—

- (1) Tax should be levied only at one point in any State;
- (2) This is best done at the first point;
- (3) Neither the exporting nor the importing State should have the right to levy sales tax on inter-State sales. Such tax becomes unnecessary as the goods will be available for taxation at one stage according to our recommendation, to the extent to which the inter-State sale is not directly to a consumer.
- (4) All manner of inter-State sales, whether they come within the purview of Article 286(1) (a) or 286(2), should be treated as forming one single category, which would be subject to Central control and no other. If it becomes imperative to levy tax on inter-State sales, the power to do so should vest exclusively with the Centre. In other words, Article 286(1) should be amended by eliminating clause (a) and the Explanation.
- (5) Goods which are declared as essential to the community under Article 286(3) of the Constitution should be free from not only future impositions of sales tax, but also from existing levies.
- (6) A uniform rate of tax may be prescribed in regard to certain articles. Under the system of Single-point tax recommended by us, it should be easy to implement such a ceiling."

HINDUSTAN CHAMBER OF COMMERCE, MADRAS

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART I.—THE TAX SYSTEM

GENERAL

Question 1.—The system of taxation should take note of the stage of economic development of the country and should be so designed as not to hinder the production of greater wealth and the maximisation of production. In any tax system foremost place and precedence should be given to the objective to provide incentives to work, to save and to invest. The taxation should leave a sufficient margin for savings and encourage its flow into investments and thereby increase the productive wealth of the country.

The Chamber is aware that the reduction in inequalities of income and wealth forms the aim of tax systems, in certain advanced countries. The importance and the place which have to be accorded to this objective depends upon the stage of economic growth of the country. In advanced economies this may be a socially desirable subsidiary objective.

There will be economic warrant for bringing about by taxation a change in the pattern of distribution if it will in no way damage economic efficiency but on the other hand will promote it.

In a country like ours whose national income is low and whose economy is yet to be developed such equalitarian objectives will mean no tangible economic significance.

The objectives of taxation to serve such purposes as to counter inflationary or deflationary tendencies or to improve the external balance of the economy are permissible subsidiary objectives.

Question 3.—Taxation in India has more often been an *ad hoc* growth and more than ability to pay the revenue exigencies have been an important factor.

Question 5.—The Chamber is aware that the proportion of tax revenue to the national income in India is small when compared to other countries. India is a country with a huge population who have no adequate means of livelihood with a proverbially low standard of living. The relative burden of taxation on the people in different countries cannot be considered apart from the stage of the economic development of the country, its national and *per capita* income and the services rendered by the State to the people in return for taxes levied. In our country where national income is low, a higher proportion of taxation to national income will impose on the people a greater burden than the one in a country which has a higher national *per capita* income. So, at present there is no scope for raising the proportion. Any raising of the proportion will injure consumption and production.

Question 7.—At present non-tax revenues are derived by the Government from such State Undertakings as Railways, Post Offices, and other Industrial Undertakings started recently by the Government. If non-tax revenues are to be increased it will imply that the State has to enter into industrial field by starting industries even in the private sector; thus it will mean the revision of the industrial policy of the Government.

However, in future, the State is likely to derive larger revenue from the new undertakings such as the Sindri Fertiliser, Machine Tools and Cable factories recently established. But it is felt that they are not likely to occupy a more important place.

Question 8.—We agree with the view that the receipts from particular taxes should not as a rule, be funded or earmarked for specific purposes.

Question 9.—It is desirable under certain conditions to levy cesses for such purposes, say for developing a particular industry, but the Chamber does not approve the levy of cess on a particular industry for the purpose of assisting a counterpart of the same industry. The Chamber have in their mind, the levy of the cess on mill cloth for the purpose of development of the handloom industry.

Question 10.—It is the view of the Chamber that it is not desirable for further extension of State undertakings. State undertakings should be treated as any other private company and as such should be liable to tax.

Question 11.—The net surplus earned by State undertakings should accrue to the general revenues. In the case of Railways, now the general revenues of the Government get a contribution of four per cent. on the outlay. Such State Commercial Undertakings should be placed on a par with private commercial undertakings and should also be made liable for the payment of income-

tax and other taxes. The surplus earned from such undertakings can also be used for the purpose of financing projects of development. In certain circumstances, the surplus can be invested in the particular undertaking concerned, for instance where there is very heavy rehabilitation to be made or great programme of development has to be undertaken.

Question 12.—*Incidence of taxation.*—In examining the incidence of taxation on various classes of people the three factors namely income, residence and occupation have to be taken in combination.

Question 13.—The burden of present tax system Central, State and Local is not fairly distributed among the various classes of the people and in different States. The burden of direct tax and tax on commodities fall more heavily upon the urban population. The various taxes on commodities in force in the State also account for the unfair distribution of the tax in different States.

Question 16.—The benefits accruing from public expenditure has to be taken into account in considering the burden of taxation. Any expenditure incurred for development, say irrigation or agriculture and social capital expenditure have bearing on the burden of taxation.

Question 18.—*Taxation and economic development.*—The Chamber is of the view that taxation should not be used for the purpose of finding additional resources to finance development of the country. Development finance has to be found by borrowing and by promoting greater production of wealth.

Question 19.—In maximising resources required for financing development, importance should be given to economy, rationalisation of expenditure and prevention of tax avoidance and tax evasion.

In the present context of the country's economic development the Chamber is of the view that there is no scope for higher rates of existing taxes.

(e) To find resources for development, it is not necessary for the State to enter into the business field. Even from the point of view of revenue to the State, it will not be profitable for the State to enter into this field for the purpose of finding finance from non-tax revenues. Undertakings by private enterprises will yield better revenue to the State.

Questions 20 and 21.—The appropriate tax relief will certainly give impetus to capital formation. Relief in the matter of taxation of companies and on individual incomes will make savings possible and help their flow in investment channels.

Question 23.—Partly out of the high cost of living and increase in taxation the saving capacity of the middle class has been very much impaired. Any tax relief accompanied by fall in the cost of living will certainly assist the growth of savings.

Question 25.—In advanced economies where the consumption standards are high, taxation can be used to restrict consumption and thus the funds made so available may be made to flow into investment channels. But the consumption standards of India being already very low any regulation of consumption standards will mean not only greater hardship on the people but also is likely to hit adversely demand and interturn production. So, it is not desirable to regulate consumption standards as a means of finding larger resources for development.

Question 26.—Multiplicity of taxes and their lack of uniformity from State to State affect the efficiency of the economy.

Taxes on commodities should at least in certain basic matters, be similar. With our Constitution having a federal structure to attain uniformity or complete rationalisation in tax structure may be difficult. Anyway by periodic meetings or conferences among States agreement could be evolved on certain basic issues relating to commodity taxes.

Questions 27, 28 and 29.—Tax policy can influence overall demand. The high taxation on commodities can check consumption and prevent the flow of funds in the production of such goods. By modifying taxation and by providing liberal concessions, say, by way of depreciation allowances by light or no taxation on returns from particular investments, inducement can be provided for desirable investment or promoting new ventures.

The Committee feel, however, that taxation by itself cannot carry far economic development. It has to be used in conjunction with other inducements.

Monetary policy by itself will not secure the desired investment. For planning economic development monetary policy and tax policies have to be co-ordinated. Taxation is a good instrument for redistribution of income and wealth so long it does not damage the primary objective of not hindering the production of further wealth.

Question 30.—The present tax system in India with its high rate of taxes on income and other tax on luxuries makes for reduction of inequalities of income and wealth.

Question 32.—In modern economic societies public expenditure has also a place in the matter of achieving greater measure of equality of income. When the State incurs expenditure in giving subsidies for food such expenditure has the effect of reducing inequality in incomes.

Question 34.—(a) and (b).—The Parliament of India has now passed a measure for the levy of Estate Duty in preference to duties in respect of succession to properties. Some States have already passed the necessary resolution agreeing to the inclusion of agricultural property in the Estates liable for duty.

(c) At present Stamp Duty is collected in respect of transaction in Stock Exchanges. Besides this, there is no possibility of levying any other tax.

(f) In the present state of the literacy of the country any tax on newspapers will not be advisable as the same would be passed to the consumer.

Question 35.—*Tax on capital.*—Already the country is faced with paucity of funds for development. It has to think of means to secure the necessary funds for financing the development of the country. In the circumstances there is absolutely no scope for the levy of a tax on capital in India. Any tax on capital will deplete capital resources and adversely affect even the little investment in the country and will ultimately affect the revenue of the State.

Salt duty.—The levy of salt duty is surrounded by political considerations. The salt duty was an old tax and if its levy is light, its incidence will also be negligible.

At present certain States levy tax on agricultural income. There is a scope for the levy of tax in the country. There should either be a surcharge on land revenue or income-tax on agricultural income.

Our country is yet to evolve social security measures. So any possibility for tax on social security has to be ruled out.

Modification of the policy of prohibition will be desirable in as much as the States will be obtaining increased revenue with which they can finance their development programmes. The modification of the policy is desirable at least until such time the country develops its resources.

Question 36.—It is feasible to levy a tax on unearned income on value of lands or other property. When land or other property has benefited from the projects constructed out of the revenues of the State it is desirable that they should also contribute to the Exchequer in as much as their increment in value is due to the projects undertaken at State expenses, but such a levy should be spread over a long period of time and its burden should be low enough to leave a margin of gain to the beneficiaries.

Question 37.—At the present stage of the economy of the country we cannot think of any other fresh source of taxation.

Question 40.—Taxation and inflationary and deflationary situations:—We cannot claim as much efficiency as in other countries for taxation as an instrument to meet deflationary and inflationary situations. But in such situations, it has its utility. India being a price economy, a change in taxation is not without its effect. If there is reduction in taxation and if it leads to lower cost, there is a tendency for consumption to expand.

If taxation is used for countering inflation by imposing new taxes or by increasing existing taxes it itself after certain point produces inflationary situations.

Question 41.—In countering inflationary or deflationary conditions in the economy first place should be given to indirect taxes.

A reduction in or abolition of indirect taxes will accelerate consumption and thus counteract deflationary tendencies. Levy of or increase in indirect taxes will act as a brake on consumption in inflationary conditions.

Among the indirect taxes first importance should be given to Sales-tax and Excise Duties.

Direct Taxes will, of course, only affect investments. So, changes in direct taxes come next.

Question 43.—Public expenditure can also moderate the forces of inflation and deflation.

In inflationary conditions except expenditure on profits which would enhance the productive capacity of the country, all other expenditure has to be avoided.

A well timed and appropriate public expenditure can mitigate the forces of deflation. But the manner in which

public expenditure is financed is also relevant. Public expenditure financed mostly out of taxation will not yield the desired results. Further in a country like India, certainly public expenditure in such basic investments as Irrigation, Power, Agriculture, etc., will be desirable to stimulate economic activity. But public expenditure calculated to increase investment in the public sector alone will not be effective in moderating deflationary forces. Investment in private sector has also to be stepped up to achieve results.

Question 44.—Tax changes for dealing with the effects of rising or falling prices on particular groups of taxpayers or sectors of the economy are desirable.

Question 45.—The present economic situation obtained today in India is that the forces of inflation have been overcome. Due to lack of purchasing power, there are signs of demand not catching up production.

Further it has been noticed that there is a fall in the level of employment.

To stimulate demand to absorb the production of the country it may be necessary to abolish certain levy on commodities.

The situation now demands that every incentive has to be provided for stimulating investment in the private sector. For the purpose re-orientation of the tax policy with a view to reduce the burden of direct taxation is also necessary.

PART II.—DIRECT TAXES

INCOME-TAX.

Question 48.—To assess to tax capital gains of industry is objectionable. The Committee understands that such a form of taxation does not exist in any country except in U. S. A., Levy of such taxes in a country like ours will prove detrimental to fresh activity. Capital for industries is usually drawn from the public who invest their savings in new enterprises in expectation of appreciation of their capital as the industries develop. If such appreciation in the value is taxed it will mean drying up of the sources from which new industries have to find their finance for establishment. Further it is common knowledge that the Government of India once sought to raise this tax and subsequently abandoned the same in view of its poor yield and of its unscientific nature.

Question 50.—Bonus Shares issued from reserves or profits should not be taxed. When Bonus Shares are issued by a Company from its profits for the purpose of capitalising or for investment in fresh machinery or assets, it does not involve any release by the Company of its assets. The Shareholder at best gets only a share but receives no money.

Question 52.—Dividend derived from agricultural companies by the Share-holders are now sought to be taxed. Dividends received from agricultural Companies should be placed on a par with the agricultural income and should be exempt from income-tax.

Questions 53 and 54.—Aggregation of agricultural and non-agricultural income by Central Act will be preferable. The yield should be appropriately assigned to the state from which taxes on agricultural income is collected.

If the above alternative is adopted, it would mean the amendment of the Constitution. But this will ensure a measure of uniformity all over the country.

The Chamber is of opinion that the Government of the States and the Union must come to an agreement by which the law relating to the agricultural income-tax and its administration are uniform, although the rates of tax may be allowed to be fixed by the States.

Question 56.—It is felt that provisions of the present Income-tax Act relating to the donations to Charitable and Religious Trusts are very stringent. If an Institution is endowed only for the benefit of any particular community there will be no exemption. There are, in the country, numerous endowments to Hindu Temples and other Religious Institutions meant for wholly for Hindus or for Muslims or Christians. These Institutions though they are endowed to benefit a particular religious community they yet benefit a large class of the public. So it is necessary that this scope of exemption should be widened and that all institutions though they might not have registered under any statute but which are founded for the promotion or development of religion, science, etc., should also be entitled to exemption.

Question 57.—Business profits of co-operative enterprises be charged to income-tax and super-tax. They should be treated as Companies. But Societies with profits less than a figure, say a lakh of rupees business profit may be exempted.

Question 64.—The personal income-tax law does not take note of the domestic responsibility of the assessee and not related to his ability to pay. So, personal and

family allowances should be provided by giving specific allowances for family and dependants. With regard to Joint Family such allowances should be granted at least to the adult male married members.

Question 66.—Rate Structure.—Yes. The Income-tax and Super Tax may be integrated wherever possible. The consolidation of income-tax and super-tax at least with respect to taxation of individuals would help the administration. This would enable the assessee to readily appreciate the tax liability. As the States have no share in Corporation Tax, it may not be possible to integrate the two with regard to companies.

Question 67.—Where a Hindu Joint Family consists of four or more persons, the minimum limit of exemption for income-tax and super-tax should at least be three times the exemption limit provided.

Question 68.—The distinction between earned and unearned income has to be maintained. The quantum relief has to be extended. It is felt that the present earned income relief is inadequate. This distinction between earned and unearned income should be extended upto the income of Rs. 50,000 that is the maximum now allowed for earned income relief should be raised to Rs. 10,000. It has been noticed that a differentiation is made in the matter of allowing earned income relief. For instance when an employee, say of Government goes on leave, in the matter of assessment, even for the leave salary drawn, he is granted earned income allowances. But such allowance is granted in a partner of a concern when he is away from the place of business.

Question 70.—A change is called for in the method of assessment of the Hindu Undivided Family. They should be treated as a registered partnership.

Question 71.—Exemption will be granted from income-tax in respect of voluntary surrender by managing agents of the whole or part of a managing agency commission if it is made *bonafide* in the interests of a company or of the shareholders.

Question 73.—The present law relating to determination of *bonafide* annual value of property and deduction allowed for it are not satisfactory. The basis of recovery of tax on national income is leading to anomalous results and the owners are called upon to pay tax to an extent not at all justified by the surplus income over expenditure. Full allowance should be granted for all such taxes paid in respect of Municipal Property Tax.

Question 74.—Carry-forward of losses.—Where a partnership ceases and any of the other partners continue the business, the carry-forward of loss, at least in respect of the share of the partners who continue the business should be allowed.

Question 75.—Advance payment of tax was introduced as a counter inflationary measure. There is no justification for continuance of the same. Anyway, it is felt that all the complications will be avoided if the suggestion made by the business community is accepted by the Government namely that the assessee may be called upon to pay the Income-tax on their estimated income along with the return.

If advance payment of tax on fifty per cent. of the estimated profits is made, there should be no penalty. Advance payment should carry interest from the date of payment to the date of provisional or regular assessment.

Question 76.—Enquiries by the Income-tax Officers should be limited to the particular subject of enquiry, but all roving enquiries should be avoided.

Question 78.—There is no necessity to vest powers in the Appellate Tribunal to enhance assessments.

Question 81.—Dividends received by a company from another company which itself has paid super-tax on its profits should not be assessed to Corporation Tax in the hands of the receiving company. Since the other company has paid tax, it amounts to double taxation if the receiving company is also taxed.

Under the budget for this year exemption from Corporation tax to dividends received by companies on their investments in specified industrial undertakings formed after 28th February of this year and to dividends received by them in respect of fresh capital issued by existing companies engaged in specified industries has been granted. The scope of the exemption granted is narrow and has to be made as wide as possible and extended to dividends received by companies from investments in other companies.

Question 85.—Industrial and commercial enterprises undertaken by the Central, State or Local Government should also be subject to income-tax.

Question 86.—Fees payable by assessee to Chartered Accountants may be made on a scheduler basis.

Question 87.—Assessee may either represent by himself or by his employee or by Chartered Accountants or

Legal Practitioners. No other class of persons to be recognised for representation before the Income-tax Office.

Question 89.—The perquisites given to employees (business undertakings) should not be subject to taxation.

Question 90.—The tax liability may be made a first charge.

Question 81.—Powers for search etc., should not be vested in the Income-tax Officers.

Question 94.—The present arrangements for recovery of Income-tax are adequate. No separate machinery is needed.

Question 95.—In the matter of collection of Income tax no distinction should be made between private limited companies and public limited companies.

Question 97.—In each circle there should be an office who should help assessee in the matter of filling up of forms and give them advice. There should be regular meetings between the Commissioners of Income-tax or Senior Officials and the Income-tax Practitioners and the assessee to exchange views on the administration of the Act.

Question 98.—Levy of penalties.—The principle that the ignorance of law is no excuse, should not be rigidly applied. First offence should be very leniently treated.

Appellate Assistant Commissioners should be placed under the Control of the Appellate Tribunal.

Recovery of tax.—There should be provision in the main Act itself vesting power in the Appellate authorities to stay recovery of the tax, penalty or interest pending the disposal of the appeal or reference to the extent to which such tax, penalty or interest is in dispute.

Question 99.—There should be no frequent transfer of officers. Before an officer proceeds on transfer he should complete the enquiry of the case which he dealt with. Whenever a loss is reported such cases are not taken up by the officers. This leads to delay.

Questions 101 and 102.—Death Duties.—Since now the Estate Duty Bill has been adopted by the Parliament. The limit of exemption from this tax has been fixed at Rs. 50,000 in respect of a share in Mitakshara Joint Hindu Family and Rs. 75,000 in other cases. The exemption limits have to be raised in view of the low purchasing power of the people and of the very much restricted nature of the item; not to be included in the estate for the purpose of this levy.

If the saving habit among the people is to be encouraged the limit of exemption of insurance policies has to be fixed somewhere in the neighbourhood of Rs. 25,000. Liberal provisions relating to rapid succession relief should be made especially in the initial years; and in view of the high rate of mortality in this country, at least for a minimum period of five years the same estate should not be liable to duty for a second time. The rates now proposed to be levied are likely to prove severe in its operation. So the initial rate should be at two and a half per cent. and the maximum at twenty-five per cent. in the initial years. There should be provision for an Appellate authority on the lines of the Income-Tax Appellate Tribunal to hear appeals against the decision of the Controller of Estates.

PART III.—COMMODITY TAXES (Central and States).

CUSTOMS.

Import Duties.

Question 110.—Under what circumstances should Customs Duties be used in preference to import quotas as a means of restricting imports?

Tariff Control should be used in preference to import quotas for the purpose of restricting imports when there is no inflation in the country and domestic production is adequate.

Further if for the development of industry it is felt necessary to restrict the quantum of imports, tariff control can achieve the purpose and can be used by the levy of import duties at appropriate levels.

Import quotas in preference to tariff control has to be employed when there is need to conserve foreign exchange resources.

Question 113.—Export duties: Under what circumstances, in your opinion should export duties be imposed?

Question 114.—What measures would you suggest to achieve greater flexibility in the rates of duties to accord with the changing conditions of export markets?

Question 115.—Would you suggest that the whole or a part of the receipt from certain export duties should be funded for financing schemes for promoting long range development of the export trade, subject to the obligations under G.A.T.T.?

The Chamber is of the view that generally export duties should not at all be levied. Even if a country has monopoly of a commodity when export duties are levied it makes the importing countries search for substitutes.

There may be occasions when export duties have to be levied to conserve domestic supplies of a commodity or raw-materials or with a view to earn foreign exchange or to absorb profits when internal prices are low compared to foreign prices.

Export duties once they are levied as experience has shown they have tendency to stick on and become rigid.

Question 116.—*Would you, in the interests of revenue or from any other point of view, recommend increased participation by the State in import and export trade? If so, what form do you think should such participation take?*

The Chamber is of the opinion that participation by the State in the export or import trade is not necessary for increasing revenue.

With the emergence of the buyers' market there will be keen competition in international markets. Under such a condition it will be necessary to make a systematic study of the market, the taste and the demands of the consumers. This task will require great adaptability, personal contact, initiative and quickness of decision. To this task the Chamber is of the view that State organisation which is bound by routine and rules and which has no personal interest will hardly be suited.

Question 124.—*Salt Duty.*—*Would you recommend the re-imposition of the excise duty on salt? If so, on what conditions?*

The abolition of salt duty has a political background. It cannot be said that removal of the levy has in any way eased the burden of taxation on the common man or cheapened the price of salt. The incidence of the tax is spread over a wide area and the burden on the consumer is very little. In view of this and in the context of the need of the State for additional resources the re-imposition of the levy will not be open to any serious objection.

Question 128.—*(a) Sales tax is almost invariably levied by the State Governments in terms of the turnover of the dealer over a given period. Since a sales-tax leviable on the individual transaction necessitates fairly elaborate accounts, cash memos, etc., which only a small proportion of dealers is equipped to maintain, do you agree with the view that, in Indian conditions, the bulk of the sales-tax is likely, for a long time to come, to continue to be leviable on aggregate turnover as distinguished from the individual sale-price?*

The Chamber is of the opinion that for some time to come the bulk of sales-tax should continue to be leviable on aggregate turnover.

Question 128.—*(b) In most States there are separate laws governing sales-tax on petrol. To what articles, if any, do you consider it desirable and feasible to extend the particular system adopted in respect of petrol?*

The Chamber is not for treating petrol separately and is of the view that there should be no separate laws governing separate commodities.

Question 129.—*(1) In regard to a system of levy based on turnover, is the choice broadly limited to the alternatives hereafter mentioned or is there any other system you would advocate? Under the system you recommend would sales-tax continue to be roughly as significant a source of State revenue as at present? The alternatives referred to above are:*

- (i) a relatively low rate of levy at each of almost all points of sale; few dealers excluded and few goods exempted (Multi-point);
- (ii) a relatively high rate of levy at only one point, viz., the point at which a registered dealer sells either to a consumer or to an unregistered dealer; exemption from tax of sales by one registered dealer to another registered dealer; exclusion from compulsory registration of a dealer below a certain limit of turnover; a large number of exempted goods (Single Point);
- (iii) various combinations of the above.

(2) Which of the above alternatives would you, advocate? Please state your reasons in some detail, comparing merits and demerits from the point of view of (a) the consumer, (b) the dealer, (c) industry, trade, etc., generally and (d) Government. Please relate your arguments, as far as possible, to lessons which may be drawn from the actual working of sales-tax Acts in different States.

(3) In particular:—

- (i) as regards (a) above, do you think that the sales-tax, or any particular form of it, leads to a greater burden being placed on the consumer than is accounted for by the proceeds which accrue to the Exchequer?

(ii) as regard (b) above, have you any suggestions to make regarding the simplification of forms, accounts etc., end of the procedure generally in order to make the administration of the tax less burdensome to the dealer? Further, having regard to the cost of maintenance of the machinery for compliances, would you suggest an alternative form of taxation so far as small dealers are concerned?

(iii) as regards (c) above, has the imposition of the sales-tax to any noticeable change in the organisation of the trade in the country, especially in regard to the size of the business unit, location of head-offices, number of intermediaries, variety of the goods dealt with etc.?

(iv) as regards (d) above, please examine the financial and administrative aspects, including the scope for evasion presented by the particular system and the difficulty or otherwise of counter acting it?

The Chamber is in favour of alternative No. (ii) for a single point tax. Sales-tax should be levied at one point that is at the point at which the registered dealer either sells to the consumer or to an unregistered dealer. There should be exemption from tax on sales by one registered dealer by another registered dealer. Dealers below a prescribed limit should be exempted. Dealers above that limit of turnover may be required to be registered.

Further sales-tax being a regressive tax it should carry liberal exemptions.

A single point tax has the merit of simplicity. It is easily understood both by the consumers and the dealers. A commodity has necessarily to change hands in the course of trade before ultimately it reaches the consumer. If every point in the course of trade is charged to sales-tax it adds to the cost of the consumer. Moreover, this has the effect of eliminating the intermediaries who have an economic function to perform. Small dealers are also eliminated and business tends to be concentrated. Manufacturers may dispense with traditional channels or selling agents or distributors and they themselves may prefer direct transaction with the consumer. From the point of view of the consumers, it is said that the elimination of the intermediaries as a result of multi point sales-tax will be to his advantage inasmuch as his cost of the article will be less. However, the Chamber feels that this advantage may result to the consumer when in a multi-point the rates are very low. In a single point the burden of tax on all the articles will be the same while in a multi-point it will vary according to the number of stages an article passes through. The number of stages an article has to pass through varies from article to article. In a multi-point tax, an article which goes through more stages will bear a heavier burden of the tax. In a single point tax the burden will be the same irrespective of the number of stages an article passes through.

Under the single point system of sales-tax the number of assesses will be less consequently the work of the sales-tax department will greatly be minimised and naturally the cost of administration and collection will be less.

From the standpoint of all concerned the Chamber thinks that a single point sales-tax will be a convenient and a preferable system to a multi-point system.

Question 130.—*In relation to the particular system you advocate:*

- (i) should there be special rates of levy, higher than the ordinary rate, for certain articles? If so, for which types of articles?
- (ii) should there be special rates of levy, lower than the ordinary rate, for certain articles? If so, for which types of articles?

Generally the Chamber is not for the different rates for different articles, but for articles of luxury there can be special rates of levy. In this connection it is important to stress the necessity for uniformity throughout the country in the matter of goods which are classified as luxuries and the rate of levy.

Differential rates are likely to direct trade from one regional to another.

Question 130.—*(iii) Which articles, if any, should be exempted altogether and why? Please elaborate the principles which, in your opinion, should underlie exemptions.*

Articles of essential consumption to the common man such as grains, pulses, fruits, condiments, edible oils, clothing, school text-books, fuel, matches and raw materials needed by the industries should be exempt from tax. The principles which should underlie exemption should be that no essential article of consumption to the common man and no basic and principal raw-materials required by the industry should be subject to tax. Further, goods which are subject to Central Excise Duty should also be exempt from sales-tax.

Question 131.—*In regard to system, rates, exemptions, etc., what degree of uniformity between the different States do you consider desirable and feasible? Would you bring it about—*

- (i) *by formal or informal convention;*
- (ii) *by central legislation promoted at the instance of two or more States;*
- (iii) *by constitutional amendment, so as to include certain basic matters connected with the sales-tax in the concurrent list?*
- (iv) *by constitutional amendment so as to include the item of sales-tax, as a whole, in the Union List? In the last mentioned case how would you apportion the proceeds? Would this alternative be a practicable proposition from the point of view of the finances of the States?*

While complete uniformity and inclusion of sales-tax as a whole in the Union list is desirable the Chamber feel that it cannot be hoped for or practicable in the present circumstances. At least in such basic matters as the basis of levy, rates, exempted goods and inter-State sales, uniformity has to be secured. Uniformity can be brought about by constitutional amendment or formal or informal convention.

Question 132.—*To what extent has any desirable uniformity been achieved in regard to exemptions (in favour of "goods essential for the life of the community") under Clause (3) of Article 286 of the Constitution? What principles would you advocate for deciding the exemptions to be made under this provision of the Constitution? Do you consider that the scope of the provision contained in Clause (3) of Articles 286 should be extended also to "essential articles" which had been subject to sales-tax before the relevant central enactment came into force?*

Article 286 in actual practice has not brought about any desirable measure of uniformity.

Clause 3 of the Article 286 regarding essential articles should also be extended to sales-tax legislation which were extended before the relevant Central Act came into force.

Question 133.—*As regards "sales outside the State", "inter-State commerce", etc., please discuss the adequacy or otherwise of the relevant provisions of Article 286 and suggest remedies for any defects which, in your opinion, have been revealed in the actual working of these provisions.*

(b) Please discuss in this connection the desirability and feasibility of the suggestion that purchases only (and

not sales) should be taxed, so that the tax jurisdiction of each State might be confined to parties residing within the State. Alternatively, do you consider that purchases should be taxed in certain cases and sales in certain others; if so, how and on what considerations would you define the two categories? In either case, please describe your scheme in some detail and explain the advantages which you claim for it.

Article 286 has been variously interpreted by the States. The expression inter-State trade has been the subject of divergent interpretation. Inter-State trade has been held to cover sales to another State for consumption in that State. If a purchaser in the second State sells to another dealer in a third State, it is said that this clause of the Article does not apply to such sales.

Further the recent Judgment of the Supreme Court has held that though the State from which the sale is made cannot subject such transactions to tax, the State in which the goods are delivered can levy a tax on such sale.

The Chamber is of the view that no tax on sales should be levied on goods passing out of a State's territory either to any other State in the Union or to a foreign place.

Further simplicity requires that the powers of the State in regard to exercise of the levy of sales-tax should be confined to its territorial limits and all inter-State transactions should be exempt from levy of sales-tax.

(b) Levy of purchase tax will certainly avoid these complications when confined to territorial limits of each State but even in such a system uniformity in the matter of levy and rates should be secured all over the country.

The Chamber is not for levy of purchase tax in certain cases and tax on sales in others. This will necessarily complicate and prove cumbersome to the trade.

Question 134.—*Do you think that lack of uniformity between the States as regards the rates of sales-tax and the methods of applying it (single or multiple point) has the effect of raising barriers in inter-State commerce or of inducing uneconomic diversions of trade? If so, what measures would you suggest to rectify the position.*

The Chamber thinks that lack of uniformity between the States as regards rates of sales-tax and the system of levy and exemption has affected free flow of trade in inter-State commerce. Uniformity in system at least in basic matters will be the only remedy.

THE INDIAN MERCHANTS' CHAMBER, BOMBAY.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

INTRODUCTION

With the rapid spread of the democratic form of Government in the present century, particularly after the end of the first World War, the scope of Government activity in the economic and social spheres greatly increased all over the world. The concept of the place and position of Government in building up a Welfare State has resulted in the administrative machinery undertaking enlarged functions. As the administrative functions increased, it became necessary for governments everywhere to raise a larger volume of revenue from the public from year to year and various forms of taxation had to be devised for the purpose of defraying the normal recurring expenditure on administration, quite apart from the developmental expenditure which also became an increasingly recurring feature. Today, in some of the economically developed countries, the revenue collected by Government by means of taxation forms a substantial proportion of national income. In an under-developed country like India, the scope for raising revenue by taxation is necessarily restricted, as compared with that in the economically developed countries, particularly of the West. It is futile to point out the high proportion of national income which these countries contribute to the public exchequer and to suggest by implication that in India too taxation can yield similar returns.

When Government expenditure was small, it was comparatively easy to obtain the necessary revenue by means of a few simple taxes which did not produce much perceptible effect on the trend of economic activity. However, as the volume of expenditure went up, Government had to tap a variety of sources for collecting the required revenue and in the process gave twists and turns to the course of economic development. As the necessity of appropriating a substantial proportion of the national income to the Treasury increased, taxation, naturally, became an important instrument of Government's economic policy. Governments everywhere now frame their taxation proposals not only for meeting budgetary expenses, but also for helping the achievement of such general objectives of economic and social policy, including the maintenance of economic stability, by counteracting inflationary or deflationary pressure, and encouragement of incentives to work, save and invest. The primary objective of a sound taxation policy, however, remains the collection of adequate revenues in a manner which would not weaken the incentive to work and impair the springs of action. For, howsoever effective the taxation policy may be in assisting the achievement of social objectives, if it does not safeguard the incentive to work, save and invest, it would have adverse repercussions on the volume of production and in the long run the standard of living, instead of registering improvement, would go down.

Direct taxation in this country has already surpassed the point of maximum returns and even in respect of indirect taxation, taking into account the very low level of *per capita* income and the high cost of living, the margin available may not be considerable. Realising that the principal goal of economic policy, which the country has to pursue and which has been embodied in the Five-Year Plan, is increased production and realising also that private enterprise has been assigned an important role in the attainment of this goal, it is essential that Governments, both at the Centre and in the States, should explore all possible means of cutting down their expenditure, particularly on administration, so as to avoid the continuance of the present policy of excessive reliance on direct taxation which has resulted in curbing enthusiasm for increased or new efforts for expansion of activity in spheres of production. The

scope for pruning governmental expenditure, particularly on administration, should be more systematically investigated and in that context, the suggestions repeatedly made, that the obligations undertaken by Government in spheres of State trading and in regard to the working of the controls designed for the period of shortages are continuing burdens in the shape of expenditure of an avoidable character, assume added importance.

The needs of the exchequer will still be comparatively large in the context of the enlarged functions undertaken by Government and avenues would have to be found for meeting those needs mainly by a re-adjustment of the existing taxes, by achieving a greater spread in the burden and by slowing down the pace of progress of proposals for achievement of certain social objectives, however laudable ideologically involving a set-back in the budgetary equilibrium by the consequent increased expenditure or loss of revenue and also necessitating the imposition of unpopular taxes at steep levels.

Out of the total Indian population of about 357 million in the year 1951, only about eight lakhs of persons were liable to income-tax. The rates of direct tax in India, for some years past, have approximated, if not in some cases exceeded, the levels elsewhere, and as a result of this heavy direct taxation, large chunks of personal incomes have flowed into the Treasury. This levelling down process has drastically reduced the volume of savings and hindered the progress of economic activity. The cause of the present subdued tempo of business activity in the private sector may directly be traced to the cumulative effect of the high level of direct taxation in the post-war period. As increased production is the principal means of raising the general standard of living, the imposition of heavy direct taxes produces a boomerang effect.

It is in the light of this wider perspective of encouraging a continuous and speedy increase in production, which is the only solution to the present low standard of living in the country that the Committee of the Indian Merchants' Chamber have attempted to express their views in reply to the questionnaire issued by the Taxation Enquiry Commission. Stress has been laid on the vital importance of incentives in the system of taxation. Liberal tax concessions are lately marked features of budgetary policy in almost all the important countries. In fact, 'incentive budgets' are the order of the day. The latest news about substantial tax concessions comes from Australia. The tax concessions recently announced amount to £A118.4 million, a substantial sum for a country of Australia's size. "In all, wage and salary earners will benefit from an average cut of 12½ per cent. in income-tax; public companies will pay 6s. (instead of 7s.) in the £ on the first £5,000 of taxable income and 7s. (instead of 9s.) in the £ on the balance, while private companies will benefit from a cut of 1s. in the £ on each of their equivalent rates. Goods previously subject to sales tax of between 20 and 50 per cent. will now carry a flat duty of 16½ per cent. (less in some cases), entertainments tax will be abolished altogether, and rates of customs and excise on spirits will be reduced by 21s. a gallon. Differential rates of tax on income from property will be removed and the exemption limits for both estate duties and payroll tax will be raised." We are emphasizing the importance of incentives in the system of taxation not with the insular object of safeguarding the interest of any special class or community, but with a view to encouraging the growth of savings and capital formation for stimulating increased economic activity and thereby ensuring all-round progress.

PART I.—THE TAX SYSTEM

General

Question 1.—What in your opinion should be the objectives of a sound tax policy? What should be the place in such a policy of the following objectives?

- (a) reduction in inequalities of income and wealth;
- (b) encouragement of incentives to work, to save and to invest;
- (c) countering of inflationary and deflationary tendencies; and
- (d) maintenance of the external balance of the economy.

In what directions would you suggest modification of the Indian tax system, having regard to these objectives?

A sound tax system is recognised as an integral part of the larger economic policy, which has for its objectives maximisation of production, increasing opportunities for high and stable levels of employment, and raising the standard of living of the people in general. In a relatively backward economy like ours, where a large proportion of the community has a sub-normal standard of living, the economic policy—and therefore the tax policy—must concentrate on achieving an accelerated pace of development by a careful mobilisation

of all its resources. As pointed out by the Planning Commission, a larger early increase in consumption and a higher rate of capital formation cannot go together, and it, therefore, becomes necessary to maintain a judicious balance between requirements of consumption and capital formation. While on the one hand, the level of consumption is to be maintained at such a level as to provide the necessary market for production, at the same time it will have to be remembered that 'unless capital formation is stepped up substantially, India will have to go on living from hand to mouth and the rate of economic advance will be small'. In other words, the conflicting claims of the need for securing capital formation to the maximum extent and the sustained consumption must be so adjusted as to bring about an optimum rate of development. Besides the objectives stated in the Question, relative importance of which we discuss below, we would like to emphasize that a sound tax system should be fair in its incidence on all sections of the community and at the same time adequate to meet the needs and requirements of an expanding economy.

(b) In our opinion, in a backward economy, besides the primary object of raising the necessary resources for meeting the expenses of Government, highest priority must be assigned to the objective of encouragement of incentives to work, to save and to invest, so that the same may result in the creation of increased wealth and in the improvement of the general standard of living of the people. It is recognised on all hands that taxation in our country has reached a stage, where it is bound to have a retarding effect on savings and investment capacity of the public. In our view, the taxation policy needs to be so re-orientated as to create conditions favourable for stimulation of capital formation for increased economic and industrial activity in the country. In this context, the Planning Commission, while they have recognised the importance of allowing private enterprise to tackle the sector of industrial development, have not given adequate consideration to the conditions and pre-requisites of any such organised development in that sector. The present steeply progressive rates of direct taxes and various other imposts and burdens in the shape of indirect taxation have considerably undermined incentives to save and to invest. In this connection, we would like to invite reference to the point of view expressed by the Planning Commission that 'increased reliance should be placed on the building up of corporate savings and public investment rather than individual savings'. In our view, the emphasis is not fully justified, inasmuch as for a long time to come for purposes of industrial development reliance will have to be placed on private savings, and it would, therefore, be necessary to afford all necessary facilities to create an atmosphere favourable for private savings.

There is, in our opinion, a very strong case for reducing the level of taxation, which has been in force for over a decade now and which has proved to have definitely prevented not only industry from conserving its resources, but also made inroads into the capacities of individuals to save. Even in industrially advanced countries like the U.K. and the U.S.A., increasing attention is being paid to the damaging effects of a high level of taxation, and the present tax system is described as threatening to "strife initiative, expansion and ultimately jobs". The following observations in the May 1953 issue of the *Guarantee Survey* indicate the trend of informed opinion on the issue elsewhere:

"Individual incomes, especially those in the middle and higher brackets, are traditionally the principal source of the savings that normally supply the great bulk of the venture capital available to new business. Small savers are not usually in a position to assume broad risks, nor are the 'institutional' investors, that have become the principal custodians of small savings. The heavy tax rates on personal incomes in general and the almost confiscatory rates on the larger ones, leave relatively little surplus for investment in equity securities and little incentive to assume the risks that such investment necessarily involves. The situation is aggravated by the Estate taxes, which further weaken the incentive to risk-taking investment and tend to depress the market for equity securities, both by forcing liquidation and by breaking up estates into smaller units, for which such securities represent a less suitable form of investment."

In our country, the case is all the more strong for evolving a tax structure which provides positive measures of relief for achieving the objective of facilitating a continual flow of savings and capital formation. It is necessary to point out that vigorous and enduring economic expansion requires not only that adequate amounts of capital be available, but also that a sufficient proportion of the capital be of the risk-taking kind and it is a matter of common knowledge that 'risk' or 'venture' capital was not becoming sufficiently available for healthy business growth, and the situation unless rectified may result in industrial stagna-

tion, financial anaemia or both. It is, therefore, of the utmost importance that the tax policy must be reviewed and revised in terms of the major objective, viz., encouragement of incentives to work, to save and to invest.

Having stated what we consider to be the primary and major objective of a taxation policy, we will now refer to the remaining objectives which, according to us, are either incidental to a taxation policy or secondary in character. The question of maintaining the external balance of a given economy and the question of counteracting inflationary and deflationary tendencies vary according to the nature and stage of development of that economy and the given combination of circumstances which may prevail at the given time in that country.

(c) In any economy, conditions either of open or suppressed inflation, where too much money chases too few goods, spiralling up the prices, or deflation where the falling off of the monetary purchasing power leading to lowering of the standards of living and running to waste of the productive power, thus affecting the cost-price structure, productivity and employment, present numerous problems of serious magnitude and attempts are made with varying degrees of success to restore conditions of normalcy and stability. Under these conditions, the phenomenon of a bureaucratic apparatus of control for allocating supplies through rationing of scarce goods with the attendant evils of loss of personal freedom, threats to personal morality, costs of a swollen bureaucracy and clumsy inefficiencies of direct control, is too well known to be discussed here.

In industrially advanced and developed countries, attempts have been made to control inflationary and deflationary pressures through timing of public expenditure and of public investment, in particular, and through other fiscal and monetary measures. But the situation presents a problem of correct assessment and estimation of the multiplicity of economic forces at play and there is a great danger of misjudging the situation and overdoing in regard to regulating the operation of policies. It is very difficult to foretell inflationary or deflationary pressures at all accurately even for short periods ahead, and inflationary pressures may give place to deflationary pressures with quite unexpected rapidity. Budgetary policy in terms of surpluses or deficits is deemed to be one of such instruments of Control. In an under-developed country like ours, however, there is little scope for using the taxation policy for producing the desired results in terms of countering inflationary or deflationary pressures. As is well known in India, tax policy, both of the Central and the State Governments, affects only about 7 per cent. of the national income, whereas the proportion of the same to national income is as high as 35 per cent. in the U.K. This aspect imposes a serious limitation to taxation policy in influencing inflationary or deflationary tendencies in the economy to any appreciable extent. Besides, in the present context of high and progressive rates of direct taxation, there may be what we have described above the danger of overdoing and thereby defeating the very objective in view. In our opinion, in an under-developed country, the solution of the problem of inflation should not be sought in terms of reduction of effective demand or through a high level of taxation, which results in affecting savings and thereby productive investment. The correct approach should be through increase in productivity, both agricultural and industrial, which alone can reduce prices and remove conditions of disequilibrium.

(d) Similarly, in respect of the question of maintenance of the external balance of the economy, where either exports are in surplus or imports exceeds exports and either an inflationary or a deflationary situation is created, it is doubtful how far taxation policy by itself can help in correcting the situation in an economy like ours. While external conditions of emergency may require certain drastic remedies, generally speaking policies such as incentives to exports, quantitative import controls, with a view to safeguarding the indigenous industries and maintaining a balance and requisite tariff and exchange regulations are sufficient to meet the requirements of the situation.

(e) The Planning Commission have referred to the objective of reduction in inequalities of income and wealth, and in recent years a certain seductive attraction is attached to taxation as a method of achieving same. While the ideal of economic equality and social justice is unexceptionable, we maintain that in a backward economy, where the emphasis should be on increased economic activity and therefore on incentives to capital formation, there is a great danger of overdoing as a result of excessive zeal in favour of an egalitarian social order. Under the conditions where the mass of population are poor, except a small section, who serve as the reservoir to irrigate the dry fields of investment and where national production is low, due care should be taken to see that the presumption of economic inequality and the policy to correct the same do not result in levelling down still further the standard

of economic life in the country. It is necessary to remember that there are very definite limitations to Government effort and action to correct the supposed inequality in the distribution of incomes, before increasing the sources of income, if at the same time the productive effectiveness of the social and economic system is to be maintained. A dispassionate analysis of the figures relating to distribution of income under the different income groups will show that only 4 per cent. of the total population is liable to Income-tax and if the aggregate income of this section of the community is distributed equally among the sector constituting 99.75 per cent., there would not be any appreciable change in the general *per capita* level of income. The emphasis, in our opinion, on the reduction of inequality of income and wealth is misplaced at this juncture. For, reduction of inequality has necessarily to be attempted not by steps designed to level down a few but by a programme of action resulting in creating opportunities for raising and strengthening the position and lot of the rest. What is required is a concentration of efforts and steps which would stimulate increased economic and industrial activity in the country, leading to all-round increase in income of all sections of the society and with it the living standards of the people.

Having regard to the views expressed by us, we suggest the following modifications in the Indian tax system:—

- (1) The excessive reliance on direct taxation as the main source of governmental revenue should go and changes in the direction of broadening the basis of the tax system should be evolved.
- (2) Towards that end the existing rates structure for direct taxation should be subjected to radical modifications and possibilities of enlarging the yield from indirect taxes, particularly by levies on sections of the community which have not borne their due share under the existing structure should be gone into.
- (3) In the sphere of direct taxation:
 - (i) the progression in the rates structure should be adjusted in such a manner as not to destroy the element of personal initiative or incentive for expansion of activities;
 - (ii) the rates structure should be simplified by prescribing a composite rate, eliminating the present practice of two distinct levies in the shape of income-tax and super-tax;
 - (iii) the income level for the maximum rate of personal taxation should undergo a radical revision so that the residue of income available for disposal would afford incentives to save and to invest;
 - (iv) ploughing back of corporate profits should be increasingly stimulated by special reductions in the tax on undistributed profits of corporate undertakings;
 - (v) the ideas relating to economic concept of profit should undergo a revision so that a charge for financing of replacement of equipments in industrial undertakings would come to be accepted as an item of expenditure in calculating profits;
 - (vi) the basis of the grant of depreciation allowance on plant and machinery should be liberalised so as to assist the preservation of the productive capacity of industry;
 - (vii) ideas relating to the computation of income liable for taxation should be revised so as to take full account of the expenditure actually incurred for purposes of earning the income;
 - (viii) the basis of the other allowances deemed as admissible for computing income for tax liability should be liberalised; and
 - (ix) greater element of graduality should be introduced in the scheme of taxation of inherited wealth.

These are some of the more important changes which we have indicated in our replies and suggestions herein.

- (4) In the sphere of indirect taxation, the suggestions for changes have been discussed in dealing with the appropriate questions. The more important among them are:—
 - (i) the important tariff should be based on board considerations designed to secure adequate revenue, consistent with the need for assisting increased production in the country and avoiding undue burden on essentials of life;
 - (ii) the structure of our export tariff should be substantially modified so as not to prove to be a check on the flow of exports from the country;

- (iii) the possibilities of increased revenue through excise where increased or additional levy would not come in the way of the progress of the industry concerned, may be investigated;
 - (iv) the re-imposition of the excise duty on salt be considered; and
 - (v) the scheme of taxation on sale or purchase of goods be so rationalised as to conform to certain essential requirements so as to make the levy less vexatious, and as to secure in the process a degree of uniformity for the purpose of this levy all over the country.
- (5) Income from land should pay a greater share to the revenues of the States concerned and this should preferably be by an increase in the rates of land revenue than by the levy of agricultural income-tax and also by the levy of betterment charges, irrigation rates, etc.
 - (6) In the sphere of miscellaneous taxation, a number of suggestions have been made which are necessarily of a detailed character.

Questions 2, 3 & 4.—*What criteria would you suggest for determining the equity of a tax system? How far is it possible to secure it in the Indian tax system?*

Does the Indian tax system conform adequately to the principle of ability to pay or do you think an extension of this principle is desirable and practicable? If so, in what ways?

Differing views have been expressed on the extent to which the taxable capacity of various sections of the community has been used by the Indian tax system. What is your view on the subject?

As already pointed out, in our opinion, a sound tax system should be fair in its incidence on all sections of the community and at the same time adequate to meet the needs and requirements of an expanding economy. Such a tax system must be as broad-based as possible, spreading the field of taxation almost over the entire community, relating the amount of contribution of each individual to his capacity or ability to pay. The term 'equity of a tax system' is generally used with reference to the distribution of the tax burden among various important classes, income groups, rural and urban sectors, etc. A tax system, which seeks to approximate the pattern of taxation in terms of the principle of equity must be based on a fair degree of variety in taxes, thereby lending elasticity and flexibility to the tax system as a whole.

Examined from this point of view, in the Indian tax system, there is not only lack of proper balance between direct and indirect taxes, but the range of both direct and indirect taxes is narrow. There has been a tendency to exploit to an unwarranted extent income-tax amongst direct taxes and customs particularly export duties amongst indirect taxes, irrespective of the possible adverse effects of the same on the functioning of our economy as a whole. Taking direct taxation first, it may be pointed out that the structure of income-tax in the country is more or less the result of a haphazard growth and Government have resorted to the facile expedient of stepping up rates of direct taxation by either increasing the basic rates or by adding surcharges in terms of their revenue exigencies. Such arbitrary changes were neither the result of an expert investigation nor warranted by the capacity of those concerned to bear the effect and consequence of the burden. We feel that there is a strong case for a scientific overhaul and rationalisation of the whole tax structure.

It has been admitted by all that income-tax has been strained to the utmost, and the same was already being manifested in the depressing effects on the investment activities in the country. Taxes on income in the pre-war years represented less than 25 per cent. of the total tax revenue of the Central Exchequer. At the moment such tax income represents over 40 per cent. of the tax yield of the Centre. As will be seen, the burden of this form of taxation is not spread in an equitable manner. Out of a total population of about 36 crores, only 0.25 per cent. is called upon to bear a burden of the 45 per cent. of the total revenue of the Government at the Centre and the remaining 99.75 per cent. of the population does not pay any income-tax at all. Even in this sphere, the allocation of the tax burden is neither rational nor proportionate. The number of assesses with income over Rs. 1 lakh per annum represents .0013 per cent. of the total population and accounts for nearly 63.5 per cent. of the total income demand. The point is aptly illustrated when we remember that in the U.K. about 44 per cent. of the population pays income-tax in the U.S.A. about 37 per cent., in Australia about 34 per cent., and in Canada about 25 per cent.

It is further significant to note that the income level for the maximum rate of taxation is much lower in

India, as compared to countries like the U.K. and U.S.A. In India the maximum rate of tax applies to an income of over Rs. 1,50,000. The corresponding figure for U.S.A. is Rs. 9 lakhs and odd and for U.K., it is Rs. 2 lakhs. Further, the Indian tax-payer is placed in a less favourable position in respect of the residue of income available for disposal, after meeting taxation, as compared to the position obtaining elsewhere. On an assessed income of Rs. 5 lakhs, the balance available to an Indian assessee would be just over 24 per cent., whereas in Canada it would be over 43 per cent., in the U.S.A. over 51 per cent. This reinforces the point that, if the larger objective of savings with a view to assisting capital formation for the purpose of increased developmental efforts in the economy is to be achieved, the rate structure of direct taxation will have to be rationalised and made more broad-based. It becomes imperative to so adjust the fixation of maximum rate of income-tax and super-tax on individual incomes and the level at which maximum rate should be applicable, that the spreading of the burden is secured more justly and evenly.

In the absence of a thorough and scientific study into the question of incidence of taxation on various classes and groups in India, it is difficult to say with any degree of precision the relative capacity of various classes and groups to bear the burden of taxation. However, on the basis of such investigation as have been made and the rough calculations as are available, it would appear that during the past few years the incomes of the cultivator and the industrial worker have relatively increased, as compared to those persons belonging to what may be described as the middle class. The lower income groups, in absence of a better phrase known as the lower class population, which forms nearly 87.6 per cent. of the total population, contributes only 13.67 per cent. of the total tax revenues, while the upper of the middle class people, which forms 12.4 per cent., contributes as largely as 86.33 per cent. of the taxes. The agricultural sector of the economy enjoys complete immunity from income-tax in some States, and it is in the fitness of things that this sector must assume its due share of the responsibility in the scheme of allocation of burdens among various sections of the community. It is generally acknowledged that the burden of increased direct and indirect taxation has fallen in a disproportionate manner on the middle class than on the cultivators and industrial workers. This can hardly stand the test of the principle of ability to pay.

In the sphere of indirect taxes, excessive reliance has been placed on customs as a source of revenue and has been looked upon as the main plank of public finance. It is doubtful whether customs, particularly exports can be looked upon as a stable source of revenue supply, since the same is particularly liable to wide fluctuations, being largely dependent on the state of international trade. Reference must also be made to the increased dependence on export duties, which have been extended so as to cover a long range of important commodities. It is pertinent to note that in the year 1952-53, export duties yielded Rs. 55.5 crores out of a total of Rs. 177 crores from customs revenue. While there may be some justification for Government to claim a share out of the high export prices under exceptional market conditions, there is considerable risk attached to the policy of obtaining a large yield from export duties, inasmuch as the result is likely to be one of adverse effects on the export trade of the country as a whole. In fact, under the unstable conditions of international trade and prices, Government had to drastically revise a number of export duties recently either by cutting them down or abolishing some altogether. In short, export duties constitute a very doubtful weapon, particularly at a time when the world market is rapidly changing over from a sellers' to a buyers' market. It is in this context that we would like to urge the need for broadening of the tax base, so as to provide compensatory sources for achieving equity in taxation.

The Enquiry Commission will have to work out a well-conceived system of indirect taxation, so as to distribute the burden as fairly and equitably as possible, consistent with the object of raising the requisite revenues. It may not be out of place to refer here to some aspects of existing taxation policy, where the State Governments have voluntarily chosen to relinquish important sources of revenue on either sentimental or ideological grounds. The prohibition policy followed by some of the States and the discouragement to activities like horse racing, etc., are instances in point. The Commission will have to view this aspect from a rational point of view and suggest such changes or modifications as may be in the best economic interests of the country. The abolition of Salt Duty provides another example, where the Exchequer has lost a source of revenue without commensurate benefits to the consuming public.

Having indicated the necessary modifications in the existing taxation policy, we would like to urge that before thinking in terms of fresh avenues of taxation, the Enquiry Commission will have first to ascertain

how far the present increase in the level of public expenditure, which has compelled Government to bring about a corresponding increase in the level of taxation, is justified, both from the point of view of the results achieved and that of the need to maintain the level. We have drawn pointed attention on several occasions in the past that an analysis of the expenditure on revenue account of the Governments, both at the Centre and in the States, reveals the most significant increase in the sphere of administration and salaries. The increase in expenditure on account of salaries at the Centre is nearly 275 per cent. and the same in the States is of the magnitude of 300 per cent. Leaving aside the expenditure on National Defence, which has increased from Rs. 52 crores in the pre-war years to nearly Rs. 200 crores, it is significant to note that the expenditure on Internal Security, such as Police, Civil Defence, Jails, etc., both on account of the Central Government and the States, has gone up from Rs. 14 crores to nearly Rs. 50 crores. In the wake of the new concept of Social Welfare State, expenditure in the sphere of Social Welfare has gone up from Rs. 16 crores to Rs. 75 crores. While the need for gradual increases in the expenditure on nation-building and social welfare activities is generally accepted and appreciated, the question naturally arises as to whether the results achieved are comparable to the rate of increases. There is ground for the belief that revenue raised by increased or additional taxation is absorbed to a much greater extent in expenditure on administration and expenditure of a non-developmental or non-productive character. We, therefore, urge for a thorough review of the existing pattern of Public Expenditure, which in our opinion has an important bearing on the proposals for a re-adjustment of the present taxation system and structure.

Question 5.—*The proportion of tax revenue to national income in India is considered small relatively to several other countries. Do you think this proportion can be raised, and if so, what tax changes would you suggest for the purpose?*

As pointed out in the First Five-Year Plan, the tax revenues, both of the Central and the State Governments represent about 7 per cent. of the national income, and it is suggested that it is one of the lowest in the world. In support, it is pointed out that the proportion of tax revenue to national income is as high as 35 per cent. in the U.K., 22 per cent. in Australia, 23 per cent. in the United States and Japan, 27 per cent. in New Zealand and 19 per cent. in Canada. But as the Planning Commission themselves have admitted, too much should not be read into these comparisons, as yields from taxation depend not only on the facilities for collection but also in the absolute levels of *per capita* income. In order to place the whole problem in its correct perspective, it is essential to remember that India has a vast population to maintain and that her *per capita* national income is the lowest as compared to the countries referred to above. While the national income of Canada is slightly more than that of the Indian Union, her population represents only 1/20th of that of the Indian Union and, therefore, the *per capita* national income in terms of rupees is about Rs. 4,000. Likewise, the U.S.A. has a national income of nearly 21 times greater than that of India, while her population is 3/8ths that of the Indian Union. In an under-developed country like India, with a very low *per capita* national income, there would be relatively little scope for raising the proportion of tax revenues to national income by means of increases in taxation, as would be possible in an industrially advanced country, without seriously affecting savings and investment, production and employment.

Income-tax rates in India are sufficiently steep and progressive so as not to admit of any further increase. The only direction in which tax changes can be envisaged is spreading over the existing heavy burden of taxation, which covers a very narrow range of the population to the rest of the community, so as to make the whole system broad-based and equitable. Possibilities must also be explored in terms of shifting a little more burden in the sphere of indirect taxation. As pointed out above, there also exists a good scope for stepping up land taxation in terms of an upward revision of the tax on land. There is also a case for Betterment Levy, since the capacity of the agricultural sector is likely to improve as the programme of development gets into operation and results in bringing about agricultural prosperity of the rural sector.

Question 6.—*Do you think that the relative place of direct and indirect taxes in the Indian tax system is satisfactory?*

We are of the view that in the present tax system there is an undue emphasis on direct taxation as a source of revenue and that there is considerable force in the argument, as has been indicated above, for shifting the emphasis from direct to indirect taxes, so as to cover a wider range of the population and make the existing tax structure fair in its incidence and equitable in its distribution.

Question 7.—Do you consider that non-tax revenues are likely, in future, to occupy a more important place than hitherto in the public revenues of India? If so, please state the sources of non-tax revenue you have in view and indicate to what extent they may be expected to contribute to the public exchequer.

Taking the Budget year 1953-54 as basis, the total revenue expected to be raised in the Indian Union is of the magnitude of Rs. 905 crores, consisting of Rs. 439 crores to be raised by the Centre and Rs. 466 crores by the States. If the same is to be classified into tax and non-tax revenues, the revenues raised by way of taxes account for Rs. 683 crores as against the non-tax revenue from sources, such as forests, railways, posts and telegraphs, irrigation, currency and mint, registration and other licence fees, stamps, etc., to only Rs. 222 crores. If, therefore, the question seeks to suggest that there will be increasing yields in terms of revenues, from nationalised enterprises, including State trading, we are definitely of the view that Governmental ventures in the sphere of commerce and industry hold little promise for achieving the objective in view.

The experience of the working of the sectors which have already been nationalised either in the sphere of industry or trade goes to confirm the viewpoint that the machinery of the State is ill-equipped, lacks the necessary knowledge and experience essential for the successful operation of such activities. In the sphere of State trading, it is a moot point whether these activities have been conducted in a manner, which would be deemed to have been in the best interests of the country. In the matter of import of foodgrains, the heavy costs which the country had to bear in the shape of abnormally high prices, should be a sufficient deterrent for any further endeavours in that direction. Centralised arrangement through State agencies for bulk purchases on an exclusive basis is beset with the obvious disadvantage that opportunities for encouraging competitive terms on normal trade basis are lost. It is in the light of this experience that it is felt that if private trade agencies had been entrusted with the work of procuring these supplies, perhaps, the country would have obtained better terms and conditions. Another instance in point is the case of iron and steel, where the procedure adopted in obtaining supplies from foreign sources on a governmental level had caused the country a tremendous loss in the form of high prices. We are, therefore, of the definite view that any extension in the sphere of State trading is not likely to result in any substantial contribution to the Public Exchequer. On the contrary, such activities if undertaken may entail heavy losses to the country as a whole.

Question 8.—Do you agree with the view that receipts from particular taxes should not, as a rule, be funded or earmarked for specific purposes?

Question 9.—Do you think that it is desirable under certain conditions to levy cesses for special purposes?

It has been recognised as a sound principle of Public Finance not to fund or earmark for specific purposes receipts from particular taxes. It is a matter of common knowledge that principles governing the imposition of taxes have no direct co-relation with the principles underlying the distribution of the same amongst the various activities of the State. At the same time, there are certain cases, in which earmarking of such receipts for specific purposes has been deemed to be both desirable and advantageous. For example, the sugarcane cess, the cess on cotton, certain licence fees, etc., are meant for promoting certain specific activities, such as further research or providing marketing facilities and thereby promoting the development and regulation in a given case. However, it would be difficult to draw any rigid line of demarcation since Government are expected to undertake a number of activities whose benefits may accrue to a given industry, both directly or indirectly.

Question 10.—State undertakings, commercial, industrial, etc., are coming to play an increasingly important part in the economy of the country. Have you, from the point of view of their significance as a source of revenue, actual or potential, any comments or suggestions to make on matters, such as further extension of State undertakings and their policies in regard to pricing in so far as this may be relevant to tax policy?

Question 11.—Would you suggest that the net surplus earned by State undertakings should accrue to General Revenues or be carried to a Fund for financing projects of development or be re-invested in the undertakings concerned?

We have already indicated in our reply to Question 7 that it will not be desirable to have any extension in the sphere of either nationalised industries or State trading, as the same is not likely to result in any substantial contribution to the Public Exchequer. However, there has been a progressive extension of the sphere of State activities in the economic field in recent

years. Beginning with the postal and railway services and defence industries, the State has made incursions in a wider field, covering multi-purpose projects, manufacture of fertilizers, telephones and locomotives. It has not only confined itself to industrial enterprises but also extended itself to services such as State Transport, State Trading and Air Services. The scheme hitherto embodied in our system of taxation on income was conceived, when the trading activities were essentially concerned to be outside the scope of Government agencies; such commercial activities which were owned and conducted by the State for reasons of a national character were on that basis exempt from income-tax.

Railways represent one of the most important nationalised State activities, and although they were free from liability to taxation, this was partly made good by an obligation to pay a contribution out of the residual earnings to General Revenues. But in view of the altered conditions, a new re-orientation in the above outlook and treatment has become imperative. Whatever may be the organisational set-up that may be evolved for the State trading activities, the fact remains that in the process the resources of the State are employed in competition with the resources of the citizens. It is, therefore, in the fitness of things that conditions of such competition should be made as even and equal as possible. Otherwise, an anomalous situation would arise, whereunder State-owned undertakings would be exempt from taxation. This would be all the more glaring, when we realise that under the new Industrial Policy of the Government of India, in certain sectors industries owned by the State would be functioning and operating side by side with corresponding industries owned by private enterprise. Besides, the State is to be exclusively responsible for the establishment of new undertakings in the spheres of coal mining, manufacture of iron and steel, ship-building, production of mineral oils, etc., while the existing units in those spheres are to be allowed to continue under private ownership. We submit that all these activities should be treated on a directly commercial basis for purposes of tax liability and the present exemption from taxation should go. With direct taxation on joint-stock companies as large-scale industries are mostly owned by such companies continuing at the present high level, it would mean that the profit-making capacity of the private-owned unit would be indirectly sweated to the extent of 50 per cent. In the existing context of affairs, there can no longer be any justification for continuing the exemption of profits of business undertakings owned and conducted by the State from taxation. The same principles of paying a fixed rate of return on capital invested as also the net profits, after allowing for depreciation, being liable to taxation, should be applicable here also. In the event of any surplus being available after making adequate provision for reserve, same may be contributed to General Revenues. If the present inequity of the difference in standards of treatment for taxation purposes is allowed to continue, the same will lead to result of an undesirable character, like mounting overheads, inefficiency in Government-sponsored undertakings, and what is more, will give a distorted picture of the relative position as between public and private enterprise.

The success or failure of a public enterprise must be judged solely from the criterion of the standard of efficiency which implies in respect of every unit of production of goods and services the minimum cost and the requisite quality. Besides, there should be a proper system of cost accounting and quality control and the maintenance of proper commercial accounts, which should be periodically audited and made public. As to the pricing policy, it is essential that the community should know the cost not only in aggregate but the cost of each important part, so as to reveal the efficient working of each section of an enterprise. The same cost again should be real cost and if there is any element of subsidy by the State it should be added to the expenditure actually incurred. This equally applies to any element of hidden taxation in the price and that should be also clearly brought out. The crux of the policy should be that the price fixed for the product should be such as to enable the enterprise to "break even" for a period of years.

Incidence of Taxation.

Question 12.—In examining the incidence of taxation on various classes of people, which of the following factors, singly or in combination, would you suggest as the basis of differentiation—(a) Income, (b) Occupation, (c) Rural or urban residence? Is there any other basis, which may be considered?

Looking to the present system of Indian taxation with the enormous growths of tax revenues which began during the war and has continued in the post-war years, it is of great importance to study the question as to how the tax burden is distributed. Such inquiry will go a long way in formulating a correct taxation policy, fair and equitable in the burden it imposes on the various

classes of people in the community. Unfortunately, no comprehensive study has been undertaken on the subject, nor any relevant data is available for the purpose of such a study. In absence of such a study, the replies should be treated as indicative of the broad trends, subject to certain inherent limitations.

While income should generally be considered the main basis of differentiation, due importance will have to be attached to the occupational and rural or urban residence bases of differentiation as well. The study of incidence of taxation in India must imply a careful analysis of the change in shifts and the distribution of incomes and changes in the distribution of tax burden among different classes, as a result of the same.

Question 13.—Do you think that the burden of the present tax system, Central, State and Local, is fairly distributed among (a) various classes of people and (b) different States?

As already indicated above, during the past few years significant changes have taken place in the tax structure and shifts and distribution of incomes to such an extent that the present allocation of the tax burden cannot be considered as fair and equitable. While the burden of taxes on the higher income groups has been steep and progressive and is accepted to have reached the maximum taxable capacity, the medium-sized income groups have also been increasingly feeling the weight of taxation. It is also felt that there has been a greater diffusion of incomes in the non-income-tax-payment sectors, including the agricultural sector. This has resulted in enhancing the purchasing power of the low income groups and in the same manner the agricultural sector has also considerably benefited in the States where there is no agricultural income-tax in operation. In an equitable system of taxation, these classes, which have hitherto enjoyed immunity from taxation, must assume their due share of responsibility. The present system of taxation has naturally resulted in an uneven distribution among different States. States like Bombay, which have a high percentage of urban population consequent upon increased activity in the sphere of trade and industry, have to bear a much larger burden, as compared to other States with lesser industrial development.

The total *per capita* taxation of the Central Government for the whole country, according to Budget figures for the year 1952/53, is Rs. 12-4-6. People of the State of Bombay, however, are contributing a *per capita* Central taxation of Rs. 29. They are also contributing a *per capita* State taxation of a little over Rs. 10, as against Rs. 8-12-0 for West Bengal, Rs. 5-13-6 for U.P., Rs. 6-5-1 for Madras. There is again local taxation, i.e., tax levied by Municipal and other local bodies to the extent of a little over Rs. 5-8-0 per head in the State. In the aggregate, the *per capita* taxation, Central, State and Local in Bombay, comes to Rs. 44-9-6 and tax burden in this State is estimated to be about 75 per cent. in excess of the all-India average.

Question 14.—Have shifts in the distribution of income in the community in recent years altered the relative incidence of taxation on various classes of people? If so, to what extent?

Please refer to our replies to Questions 2, 3 and 4, as also to Question 13.

Question 15.—Do you think that the cost of compliance with tax regulations adds materially to the burden of taxation? If so, in respect of what taxes? Please give details.

The growing complexity of the various Tax regulations has added substantially to the burden of taxation. The requirements under the Income-tax and the Sales tax laws in particular have entailed elaborate systems of accounting and maintenance of books for meeting the requirements of tax assessments. This has imposed a very heavy burden on small traders and medium-sized industries. It is of the utmost importance that careful consideration should be given while introducing any tax changes to the point that compliance with the regulations does not involve an unduly large burden on the tax-payers.

Question 16.—Do the benefits accruing from public expenditure have a bearing on consideration of the burden of taxation? If so, how would you take this into account in considering the burden of Indian taxation?

In the hands of modern Governments, tax structure has become an effective instrument of policy along with public expenditure, and therefore it becomes necessary to strike a balance between the incidence of all taxes and the incidence of total expenditure. It is equally necessary to calculate the incidence of public expenditure, with a view to realising the benefits accruing from the public expenditure to various classes. Such a process will considerably help in co-relating the burden of taxation with benefits accruing from public expenditure and evolving a fair and just tax structure. Viewed from this point of view, there appears to be a fairly

sound case for a greater shift in the direction of indirect taxation as also the rural sector which is likely to derive a fairly large share of the benefits without corresponding liability to taxation.

Question 17.—Do you think that the tax burden weighs particularly heavy on any individual industry or occupation, and if so, please furnish the Commission with the evidence on which you rely.

Apart from the question of burden of taxation on industries in general, associations representing industries, such as cotton textiles, sugar, transport, etc., would be in a better position to provide the type of evidence in support of the contention that the tax burden weighs heavily on specific industries.

TAXATION & ECONOMIC DEVELOPMENT.

Question 18.—What role would you assign to taxation vis-a-vis various types of borrowing in finding the additional resources required for the development programme of the country?

The question of finding additional resources to implement the development programme of the country is an important one, and raises the question of alternative ways and means of finding the requisite resources. In order to be able to judge the question in its proper perspective, a brief reference may be made to the financial aspects of the development programme envisaged in the First Five-Year Plan. During the two years of the Plan in operation, the Central and the State Governments found approximately Rs. 363 crores towards the total outlay of Rs. 584 crores. The balance was accounted for by foreign loans and grants taken credit for and the sale of securities held in reserve and by withdrawals from the Central Government cash balances. It is further significant to note that, while the Central share of expenditure has been according to schedule, the performance on the part of the States has not been satisfactory. During the remaining 3 years of the Plan, programmes involving expenditure to the extent of Rs. 1,484 crores will have to be implemented. Out of this, not more than Rs. 600 crores is proposed to be realised from budgetary resources. Making due allowance for deficit financing to the extent of Rs. 215 crores expected to be provided for from Sterling Balances, there will still be a gap in the resources of the order of Rs. 600 crores, which will have to be met by additional taxation and borrowing, further external assistance and in the last resort by additional deficit financing.

As to the alternative suggested in the question, we believe that in view of the existing level of taxation and the numerous other burdens, it is clear that much cannot be expected through additional taxation, and apart from other alternatives such as external assistance, deficit financing, etc., increased reliance will have to be placed on borrowing. It is further pertinent to point out that it has been recently decided to increase the expenditure on the Five-Year Plan by Rs. 175 crores for financing new specific schemes, with a view to expanding the employment potential in the country. The problem of finding the additional finance, therefore, gains more in importance, and we would even venture to suggest that, if the choice is between spreading the period of the Plan and undergoing a period of austerity consequent upon additional burdens in the shape of increased or new taxes, we would express our choice in favour of the former.

The borrowing programmes of the Centre and of the States as envisaged in the Plan amount to Rs. 385 crores over 5 years. As indicated by the results of the recent State loans, with a well-conceived Plan of borrowing, creating the necessary climate in terms of offering suitable incentives for tapping the available supply of loanable funds, we feel that there is considerable scope for increasing the amount of State borrowing. There is also much scope for intensifying the small savings campaign and if properly tapped this can significantly augment the resources of the State. These efforts will be in conformity with the accepted view that developmental programmes of a productive nature should be largely financed by borrowing, instead of resorting to the method of obtaining revenue surplus by way of high oppressive taxation measures. All efforts must, therefore, be made in the direction of creating favourable conditions and offering such attractive rates of interest as would make it possible for the State and the Centre to obtain adequate loanable funds for their development programmes.

Question 19.—In maximising the resources required for the financing of development, what degree of importance would you assign to (a) economy and rationalisation in expenditure, (b) prevention of tax avoidance and tax evasion, (c) higher rates of existing taxes, (d) fresh taxes, and (e) development of non-tax revenues?

As pointed out in our reply to Questions 2, 3 and 4, first priority should be given to the aspect of economy and rationalisation in expenditure. There is a strong

case for a thorough review of the existing pattern of public expenditure, inasmuch as greater part of this is being absorbed by expenditure on administration and particularly expenditure of a non-developmental or non-productive character. Government have already shown serious concern over the inadequacy of the finance made available by the State Governments for the implementation of the Five-Year Plan, and have drawn pointed attention to the fact that in several States there have been increasing expenditure on non-development items. They have further urged for greater vigilance concerning proposals for expenditure on different kinds of administrative establishments, buildings, etc. Besides, the Planning Commission have deprecated the tendency on the part of States to take on hand development schemes not included in the Plan, despite their inability to raise additional resources thereby jeopardising the successful implementation of the Plan. In our view, except in the case of certain indirect taxes and betterment levies and increased land revenues, there is little scope for raising the necessary finances for development through higher rates of existing taxes or fresh taxes. We, therefore, place great emphasis on (a), *viz.*, need for economy and rationalisation in expenditure. In this connection, it is not out of place to emphasize the need for subjecting the existing expenditure on development projects to constant check and scrutiny, so as to avoid the possible dangers of waste, inefficiency, and corruption, invariably associated with the working of such projects.

Regarding (b), *viz.*, prevention of tax avoidance or tax evasion, we would like to urge a more positive approach in terms of remedying the causes which lead to such anti-social activities. It is a matter of common knowledge that excessive and penal rates of taxation are largely responsible for the temptation for avoidance or evasion of tax liability. It is, therefore, necessary that the tax structure should be made both reasonable and rational, so as to reduce or eliminate possibilities of evasion. This will also provide necessary incentives to increased production and consequent distribution, thereby creating incomes which would be liable to taxation. We have already referred elsewhere to the need for creating an atmosphere of helpfulness and co-operation on the part of the Income-tax authorities, so as to bring about better understanding and minimise possibilities of evasion. Attempt should also be made to eliminate the present administrative harassments to the public and a new reorientation in the attitude of Income-tax authorities towards the public is called for, with a view to promoting better relations between the Taxing authorities and the Tax-payer.

Question 20.—Under the Five-Year Plan, the public sector is expected to undertake a larger investment, an important place is also assigned to the private sector in the development programme. How would you devise a tax policy suitable to the development programme of the country in both sectors?

Question 21.—What part can tax policy play in stimulating capital formation in the private sector consistently with the needs of the public sector?

While in the assessment and allocation of resources envisaged in the First Five-Year Plan due provision has been made for financing the public sector, the private sector, which is expected to play its role in the development programmes, is expected to rely on its own resources. Also the responsibility for developing the private sector in the field of industry, except in regard to certain specified industries such as the integrated steel plant, industries for manufacturing heavy electrical equipments, fertilisers, etc., will mainly rest with private enterprise. While the role assigned to private enterprise in respect of industrial development is appreciated, it is felt that the Plan has not made any adequate provision for creating conditions conducive for the fulfilment of the responsibilities placed on the private sector. An investment of Rs. 233 crores is involved in the programme of development for the 42 organised industries in the private sector. In addition, industries have also to find resources for expenditure on replacement and modernisation to the extent of Rs. 155 crores, and if we add to this the need for additional investment in the shape of working capital, the balance required for the sector will be of the order of Rs. 533 crores. Having regard to the fact that the total investments in the first 2 years have come only to Rs. 60 crores, it is of the utmost importance to make necessary provision in terms of creating suitable climate for savings and capital formation for the private sector so as to enable it to play its role towards achieving the objects envisaged in the Plan.

In this context, it is necessary to remember that the rising cost structure and the diminishing margin of profit and the increased incidence of further burdens by way of additional taxation have considerably reduced the capacity of industries for providing resources necessary for various development schemes. It, therefore, reinforces the plea to so devise the tax policy as to provide the necessary scope for savings and invest-

ment so essential for the private sector to keep its pace with the public sector. Government through their taxation policy must provide facilities for private enterprise to increase corporate and personal savings and also give such direct assistance in the form of special concessions, such as higher initial depreciation allowances, etc., in cases where the profits are ploughed back for investment for expansion of existing or growth of new industries. The tax policy in our opinion can play a very significant and positive role in stimulating capital formation in the private sector. Government must bring about a reorientation in the tax policy, so as to release forces which encourage and promote personal and corporate savings and consequently capital formation, which alone can make industrial development possible by assuring a normal and regular flow of capital. It may not be out of place to refer here to the remarkable industrial development which has taken place in Puerto Rico as a typical case of backward economy. Government in spite of the system of mixed economy have formulated a special "Aids-to-industry" programme whereby complete exemption from income-tax, property tax, and municipal licence taxes has been granted to new industries and certain old industries. Such tax incentives and exemptions have proved to be an effective instrument for industrialisation. We are of the opinion that development in private sector fostered in this manner will be supplementary to the expansion achieved in the public sector and will go a long way in providing increasing employment opportunities, fulfilling the overall economic expansion and the consequent raising of the standard of living of the people.

Question 22.—(i) Is there evidence for the view that the rate of private capital formation in the community has been lower in the last few years as compared to the pre-war period? What factors, in your opinion, account for decline?

(ii) Has there been a shift in recent years in the sources of capital formation in the private sector as between individuals, corporations and other institutions?

(i) There is no reliable data available for the rate of private capital formation either in the pre-war period or for the post-war years. However, it could definitely be stated that, whatever quantum of capital formation is possible in the post-war years, is considerably lower, relative to the requirements of the industries, and in cases it is not even sufficient for maintenance of existing capital. This is confirmed by the Report of the Fiscal Commission, when they state that "there can be no doubt about post-war trends in general—that the rate of capital formation has declined". In an under-developed country with a sub-marginal living standard for a larger sector of the population and where joint stock enterprise has not developed, savings are to be drawn from a small proportion of the population, *viz.*, those engaged in industry, trade, commerce or profession. This basic fact has been often ignored in calculating the damaging effects of a high tax structure on savings of this sector, on which the country has mainly to depend for capital formation. Amongst the important factors, which operate as a check on the process of capital formation, may be mentioned the high incidence of direct taxation, existing Income-tax regulations, which do not make adequate provision for depreciation and maintenance of capital, inadequate credit facilities for the smaller and medium-scale businessmen, restrictive regulation and control on commerce and industries and unrealistic policies in respect of price fixation, bonus awards, etc. It is in this context that it is felt that the tax structure today is inequitable and as judged from canons of equity, simplicity, etc., strikes at the very foundations for planning of industry by drying up the springs of savings. It may be relevant to quote here a well-known observation that "tax legislation which impedes, discourages or retards capital formation consumes the seed-corn of our economic life".

(ii) As has been pointed out elsewhere, there has been a shift in recent years in the sources of capital formation and it may be generally observed that the shift has taken place in favour of corporate savings and other financial institutions. The individuals, who constituted hitherto an important source of savings, are no longer in a position to play their traditional role on account of both increased direct taxation and indirect taxes and levies, which the Governments at the Centre and in the States have imposed from time to time. The position of the middle-class, and the lower middle-class, who have been particular victims of this can be more aptly described in the words of Prof. C. N. Vakil, "The euthanasia of the middle-classes, which is being gradually brought about, thanks to the continuance of the period of high prices and of low fixed incomes, does not augur well for the economic development of the country..... It is widely believed that the re-distribution of income that has taken place during the war and the post-war period has not benefited the middle-classes, who formerly provided the sheet-anchor for the borrowing programme of Government and private enterprise. What is not equally widely realised is that the

taxation policy of both the Centre as well as the State Governments has been excessively burdensome on these classes and the cost of the various social amelioration measures undertaken by the Governments has been largely borne by them through sales taxes and higher prices."

Question 23.—Do you think that tax relief in respect of persons in the middle-income group would assist the growth of savings or mainly promote consumption?

In view of what is stated above, tax relief to the middle-income group will result in a major part of it being saved. Only a part of it is likely to be utilised for maintaining their customary standard of living.

Question 24.—The Planning Commission have given an estimate of the rate of progress in regard to national income and consumption standards on the assumption of 50 per cent. of the additional output going into investment each year after 1956-57. What measures in the field of taxation are necessary if this assumption is to be realised?

At the outset, it must be pointed out that the available data for an analysis of output and consumption requirements by different sectors of the community is very meagre and there is no scientific analysis available, except scattered information on which the assumption is based. We believe that the target of saving arrived at by the Planning Commission as a difference between larger output and lower consumption requirements is on the high side, having regard to the fact that the vast majority of the people are already living on sub-marginal subsistence level. Any further inroads into the consumption standards would mean considerable hardship, affecting the efficiency of the people. The State is expected through fiscal and other measures to regulate consumption standards within limits and thereby increase resources for investment. This enlargement of public savings has to be achieved through taxation and through the earnings of public enterprise as one of the major means. We have already indicated above that there is a limited scope for both from the point of view of creating increased resources in the existing conditions, and in that context the need for curtailing expenditure and making the existing tax structure as broad-based as possible, so as to make available as large a proportion of savings for purposes of re-investment.

Question 25.—Do you accept the view that some regulation of consumption standards is desirable as a means of releasing larger resources for development? If so, what part, in your view, can tax policy play in this process and what should be the relative role of direct and indirect taxes in achieving the purpose?

In a backward economy with a very low standard of living for the vast majority of the population, there is little scope for lowering the present consumption standards with a view to realising larger resources for development. Nor can any significant results be achieved through regulation of consumption standards of the small section of the people in the upper income groups, in this direction. In the present context, there is little scope for increase in direct taxation, and direct taxes can but play a limited role in reduction of consumption.

Question 26.—How far can tax policy help to promote the efficiency of the productive system? Do you think that multiplicity of taxes in India in respect of the same commodities and their lack of uniformity from State to State affect the allocation of resources in the community and hence the efficiency of the economy? Have you any suggestions for the rationalisation of the country's tax structure in these respects?

The tax policy can help promoting the efficiency of the productive system, firstly by providing suitable reliefs with a view to encouraging replacement and renewal of plants, and secondly by minimum interference in the smooth working of the competitive economy through free inter-play of price mechanism and economic forces. Multiplicity of taxes in respect of some commodities and lack of uniformity in regard to the same from State to State very seriously affect the allocation of resources and consequently the efficiency of the economy of the country as a whole. Reference may be made here to the different systems of sales tax operating in the country from single-point to multiple-points, resulting in displacement of normal trade channels and diversion of trade and commerce. The existing systems of sales tax in the country, which completely lack any uniformity have produced very serious repercussions on inter-State transactions. There is great need for rationalisation of the country's tax structure in this respect and for evolving a uniform system of sales tax with a view to removing the adverse effects of the same on the economy as a whole.

Question 27.—How far in your view could the tax system be used to secure any order of priorities in the development programme in the private sector?

One of the methods recognised for the purpose is the system of differential tax measures affecting different industries in terms of a certain order of priorities. However, there are serious limitations to this and we believe that the existing provisions of the Industries Development & Regulation Act can be used with advantage for the object in view.

Question 28.—What are the possibilities and limitations of tax policy as an instrument of economic development: (a) by influencing overall demand, (b) by reducing consumption and unessential investment, (c) by positive inducements for desirable investment, (d) by redistribution of incomes, and (e) in other ways?

While it is recognised that tax policy can be utilised as a powerful instrument for economic development, it is necessary to emphasize that in a backward economy it has to operate under definite limitations. As already pointed out, in a poor country there is little scope for tax policy being geared up for reducing overall demand and in reducing consumption and unessential investment. "Aid to industry" programme, as indicated earlier, can provide positive inducements for certain types of desirable investments.

Alternative (d) is already replied to in earlier questions.

Question 29.—How would you assess the scope and efficacy of tax policy as compared to monetary policy and direct controls as an instrument of planned economic development in India?

A tax policy aiming at a rationalised and broad-based tax structure can play an important part as an instrument of planned economic development. Planning is essentially a problem of investment and to the extent that a sound tax policy facilitates savings and consequent capital formation, it can accelerate the rate of economic progress in a backward economy. Monetary policy forms an integral part of the broad economic policy which a country follows and as such monetary and fiscal policies judiciously used can become a useful instrument for ensuring the sound working of the economic system. Except under conditions of emergency we do not favour the use of direct physical controls. We hold that a properly working price system is definitely better than the system of physical controls as the normal methods of regulating economic life. It may not be out of place to quote here the views of Rt. Hon. Balfour of Burleigh, D.C.L., D.L., on the subject: "The price system is not only more efficient than physical controls but also more democratic. It is important to stress this because it now seems to be widely believed (often unconsciously) that the free price system is in some way morally suspect and that rationing and controls are in some way ethically superior and pay greater regard to social values. The truth is the very reverse. Yet there are people about—surely for the first time in our history—who seem to believe that rationing and controls are not only desirable as a normal feature of our economic life but represent an actual advance in economic organisation by comparison with the price system. Any such doctrine I regard as a complete fallacy."

Question 30.—Do you think that the present tax system in India makes for a reduction in inequalities of income and wealth?

The highly progressive and strict system of direct taxation in the present system ostensibly aims at reduction in inequalities of income and wealth by taking away substantial portion of income from the higher income groups. The same is directly confirmed by the Estate Duty measure where the statement of objects and reasons clearly mentions that the measure is calculated to reduce the existing inequalities in the distribution of wealth. However, in a backward economy there is a limited scope for using the tax system as an instrument of reduction in inequalities and if overdone the same may defeat its own purpose. What is important and should receive first priority is the problem of bringing about conditions of all-round economic development so as to be able to raise the standard of living of the people by increasing the total wealth of the country.

Question 31.—What modifications in the tax system would you suggest for securing a larger degree of economic equality, consistently with maintaining the incentives to capital formation and higher production?

The paramount need in a backward economy for maintaining and even increasing the incentives to capital formation and higher production has already been emphasized. As the limit has been reached as far as the present tax system is concerned and if attempts are made to make the same more steep or progressive, it will very seriously affect incentives to saving and capital formation ultimately defeating the objective of an all-round economic development. The emphasis should be first on achieving greater degree of development and towards that end creating conditions favourable for that. The stimulus given by such development will

inevitably result in increased benefit to a larger sector and a progressive elimination of the disparities in standards.

Question 32.—What place would you assign to public expenditure as compared with the tax system in achieving a greater measure of equality of income?

The fiscal instrument of public expenditure is mainly to be undertaken for widening the capital base of the economy, i.e., for increasing the productive power of the community. The broad objectives of this public expenditure must be to strengthen the economy in such a way as to make it capable of attaining progressively higher levels of output in course of time, and securing an increase in output of some essential consumption goods. Viewed from this angle, large-scale investment by the State for basic development can be a major instrument for securing economic equality, for it is through such investment that the agriculturists and other rural workers will be able to build up economic strength. We, however, deem it necessary to pointedly refer to the other aspect of public expenditure, viz., various measure of social welfare policy. There is need for a judicious determination of the appropriate plans amongst various programmes of public expenditure, and it will be risky to try to divert larger funds on measures of social policy, particularly in a background economy at the cost of economic development. In a system of mixed economy as is envisaged in the Plan, a special contradiction is likely to arise between development policy and welfare policy, if part of the economic development is to be financed mainly by the private sector. In this context, the tendency to finance welfare schemes through progressive taxation comes into sharp conflict with the necessity for providing the essential incentives for capital formation.

The views of Mr. Teodoro Moscoso, based on the experience of industrial development in Puerto Rico, may be quoted here with advantage:—

“A progressive welfare-oriented policy has strong internal pressures for increasing expenditures on housing, schools, roads, aqueducts, sewers, and other services on purely humanitarian grounds and without relation to the development implications. The implications of such a policy are manyfold. First, these services, though manifestly desirable are not inherently productive. Their provision diminishes the sums available for development activity *per se*. In the second place, such facilities generally, though not always, incur future operating charges which may be difficult to meet. These very drastic qualifications on the desirability of welfare must be constantly borne in mind but not to the extent that they reduce such expenditure below the level compatible with economic development, as when the health and education of the labour force are not improved with sufficient speed.”

Question 33.—Have you any changes to recommend in the tax policy in relation to the investment of foreign capital in India?

We have no special recommendations to make in the sphere, except to emphasize the point that the tax policy in relation to investment of foreign capital in India should not in any way be discriminating against the investment of Indian capital, in respect of any of the terms granted for the purpose.

Question 34.—Art. 269 of the Constitution enumerates the following taxes which may be levied and collected by the Union but the proceeds of which are to be assigned to the States:

- (a) duties in respect of succession to property other than agricultural land;
- (b) estate duty in respect of property other than agricultural land;
- (c) terminal taxes on goods or passengers carried by railway, sea or air;

- (d) taxes on railway fares and freights;
- (e) taxes other than stamp duties on transactions in stock exchanges and futures markets;
- (f) taxes on the sale or purchase of newspapers and on advertisements published therein.

How do you assess the possibilities of adding to the country's tax resources in respect of the above items?

In the present context of affairs, we do not think that there is much scope in materially adding to the tax resources of the country in respect of these items.

Question 35.—Other possible ways of adding to tax receipts which have been suggested are taxes on capital, reintroduction of the salt duty, surcharges on land revenue, betterment levies, agricultural income-tax, social security taxes and modification of the policy of prohibition having regard to the directive principles of the Constitution. What are your views re: the desirability and the probable scope of each of these forms of taxation?

The suggestion for reintroduction of the salt duty is on strong grounds. We also consider the surcharges on land revenue and agricultural income-tax as justifiable, in view of the recent shifts in the income of the agricultural sector. Likewise, owing to the proposed developmental expenditure in the sphere of agricultural development, the imposition of betterment levies can be considered with advantage, particularly in areas which benefit from such developmental activities undertaken by the State.

We do not favour the imposition of social security taxes and taxes on capital, inasmuch as these are likely to increase the already heavy burden imposed on industries at present and will result in retarding capital formation.

Question 36.—Do you consider it desirable and feasible to levy a tax on unearned increments in value of land and other property as a result of public projects of development?

It will be desirable to devise a scheme of levying tax on unearned increments in value of land and other property, as a result of public projects of development.

Question 37.—What measures would you suggest for increasing the receipts from existing sources of revenue?

As far as direct taxation is concerned, it must be remembered that the present high rate of income-tax is subject to the law of diminishing returns, and in fact it has already reached a point where there is a strong case for bringing down the rates to a reasonable level and readjusting the same in a broad-based manner so as to maintain the necessary returns from these sources. As to the sphere of indirect taxes in a backward economy where a large number of people are poor, it is a question whether indirect taxation should be used to produce the desired effect of reducing the propensity to consume.

Question 38.—What other new sources of taxation can you recommend?

The scope for new sources of revenue has already been indicated in replies to earlier questions.

Question 39.—To what extent and as regards what taxes should the powers of the Centre to impose surcharge under Art. 271 of the Constitution be used?

There is no scope for the Centre to impose surcharges as there is already a heavy burden of taxes on trade and industry.

TAXATION AND INFLATIONARY AND DEFLATIONARY SITUATIONS

Question 40 to Question 45.

These aspects have been covered in a general way in our observations on Question 1(c).

PART II.—DIRECT TAXES

INCOME-TAX

Before entering into a discussion of the specific points or issues covered by the questions in this part of the questionnaire, we would like to make some observations of a general character in order to emphasize the directions in which the scheme of direct taxation, both in its structural aspect as also in its detailed provisions, requires to be considerably modified. Earlier, we have already referred to the growth of the incidence of direct taxation and the increasing nature of the share of the yield from direct taxes. Taxes on income, in the pre-war year, represented less than 25 per cent. of the total yield of the Central Exchequer. At one time, during the war period, it had gone to nearly 70 per cent. and, at the moment, nearly 45 per cent. of the tax

yield of the Centre comes from taxes on income. Another striking feature which has been the subject of criticism is that the burden of direct taxation is not spread in a reasonable manner. The middle-class and the upper middle-class people are called upon to bear a disproportionate share. In proposals for reforming the structure of direct taxation, therefore, the importance of efforts to reduce or eliminate this disparity cannot be over-emphasized. The greatest drawback, however, of the present scheme of direct taxation is that the income level for the maximum rate of personal taxation is much lower in this country than in some of the advanced countries like even the U.K. and the U.S.A. The residue of income available for disposal, after

meeting tax dues under our system, also compares less favourably with the position obtaining elsewhere. The main problem, therefore, is one of evolving proposals which would result in securing the spreading of the tax burden more evenly and revising the rate structure in such a manner as would assist the conservation of a part of the income for utilisation in developmental purposes. The changes necessary for realising the above objective are being indicated in detail in reply to the different questions. At this stage, we would only wish to emphasize that the Commission will necessarily have to give great importance and thought to these aspects which are of a cardinal nature, in any attempt to make our scheme of direct taxation more rational.

The detailed nature of the questions in this part of the questionnaire dealing with the Income-tax law and procedure, naturally raises the presumption that the recommendations of the Commission would cover not only the broad aspect of the structure of taxation, but also detailed provisions of the law embodying the scheme of taxation as such. We would like to point out that the structure and law of direct taxation in the country are, more or less, the result of a haphazard growth. Revenue exigencies, from time to time, have led to the expedient of stepping up rates, imposing surcharges or making flat and all-round increases in the rates, such changes not being the result of anything like an expert scrutiny or warranted by the capacity of those concerned to bear the effect and consequence of the burden. There is, therefore, a strong case for rationalising the whole structure. The depressing effect of the existing scheme of taxation on investment activities in the country has come to be recognised. The main problem, therefore, is to devise a tax structure which would be considered fair in its incidence by all sections of the society and, at the same time, adequate to meet the needs and requirements of an expanding economy. In the ultimate analysis the taxation policy and procedure should subserve the larger economic policy and should not come in the way of the larger objective of increased investment support for the country's programme of development and reconstruction.

The complicated nature of the tax law is another aspect which has been the subject of critical comments. Successive attempts to make the tax more productive and the consequent over-growth of amendments have resulted in making the Income-tax law cumbersome and involved with the result that the average assessee has inevitably to invoke the assistance of experts in discharging even the normal requirements under the law. It is not that every assessee is in a position to commend the assistance and services of qualified experts and the feeling of harassment caused by the complicated nature of the tax law calls for special attention.

Apart from the need to adjust the progression in rate in such a manner as not to destroy the element of personal initiative or incentive for expansion of activities, consolidation of the rate structure in such a manner as to avoid taxation under different nomenclatures is very desirable. The rate structure should be simplified by prescribing a composite rate, eliminating the present practice of two distinct levies in the shape of income-tax and super-tax, although both the taxes, in effect, are taxes on income. Since the rate structure has recognised the principle of progression in rates adjusted according to levels of income, there does not appear to be any special justification for preserving the two taxes under different nomenclatures, and there is overwhelming justification for the point of view in favour of a consolidated rate. Such a combined rate would also remove the anomaly of the alleviations or reliefs accruing to the assessee under certain circumstances not being available so far as super-tax is concerned. Illustrating the point, earned income relief and relief in respect of dividend income are not available for estimating super-tax liability. With a composite rate this type of hardship will be removed.

Suggestions have been made, from time to time, both by us and by other representative organisations, in regard to the changes and reforms necessary in the existing provisions of the law and the scheme thereunder as also in regard to the manner and method of applying and administering some of those provisions. We request to be allowed to recapitulate some of these suggestions which are of vital importance in any effort to ensure that the scheme of direct taxation takes due account of the practical needs and requirements of the situation.

Depreciation Allowance and Replacement Cost

The present provision in regard to the grant of depreciation allowance have been found, from practical experience, to be inadequate. They require to be liberalised in the following directions:

The second proviso to Section 10(2)(vii) of the Indian Income-tax Act treats excess sale proceeds of machinery or plant as income liable to taxation. Thus, when any asset is disposed of, where the amount for which the

same is sold exceeds the written-down value, so much of the excess as does not exceed the difference between the original cost and the written-down value is deemed to be profits of the year in which the sale took place and assessed to tax. This results in a great disadvantage to undertakings having assets of large value. It is common ground that the outlay for a new unit, in the process of replacement, is of an increased magnitude and as such the taxation of the excess proceeds of the discarded machinery is a definite handicap. Such excess should be allowed to be ploughed back, free of tax liability, for subsequent use in the process of replacement.

The present arrangement regarding grant of depreciation is linked to the original cost of the machinery. The theoretical assumption is that the sum of all these annual allowances plus any proceeds on the sale of the plant as scrap should equal the cost of replacing the asset. Even under fairly stable prices, the improvements in technique or designs of plant and equipment affect the estimate of such allowances on that basis. In a period of rising prices and rapid technical improvement, the cost of replacement will be disproportionately high and the fund built up on the basis of the present calculation will be only a proportion of what is necessary to replace the asset by a new unit of the same productive capacity. The question as to how far the factor of replacement cost has to be taken into account in determining the basis of allowance for depreciation, is one of the major problems which the Commission will have to tackle. Government have for purposes of Railways accepted the principle of linking Depreciation to Replacement Costs. The real solution of the difficulty will have to be attempted by a radical change in the ideas relating to the economic concept of profit so that some kind of charge for financing of replacement of equipment would come to be accepted as an item of expenditure in calculating profits. The acceptance, in principle, of a system of tax-free replacement reserves, with some safeguards to ensure that those reserves are used only for replacement purposes, will, perhaps, offer a practical solution to the difficulties inherent in this present arrangement. Grant of additional depreciation allowance on a tax-free basis to meet the differential cost of replacement, grant of interest-free loans by Government or statutory lending authorities like the Industrial Finance Corporation for assisting replacement programmes, etc., are some of the other suggestions which may be favourably examined by the Commission. In the case of Plant and Machinery required by purchase, practical difficulties have been experienced in the process of administering the provisions in regard to Depreciation. The Income-tax Officers, it appears, are sometimes inclined to question the purchase price as recorded in the books of the purchasing company and to disallow the quantum of depreciation claimed, on the ground that the purchase price was higher than what should be normally allowable in his opinion. Whenever such purchase price is indicated or mentioned in any document of transfer or sale, the same should be taken as *prima facie* correct, unless there is occasion to suspect fraud, and accepted for purposes of grant of Depreciation.

Anomalies and Difficulties experienced under Section 23A

We had, in the past, on more than one occasion, drawn the attention of the authorities to the anomalies inherent in the present provisions relating to taxation of income of companies in which the public are not substantially interested, under Section 23A of the Indian Income-tax Act. The question of liberalising compulsory requirements in the provision so as to allow sufficient freedom and initiative to the shareholders of such companies to conserve a portion of the profit made in a particular year for the purpose of assisting a programme of expansion, requires to be immediately tackled. It is but proper that instead of a private company under such circumstances being obliged to borrow money from outside sources for purposes of its developmental requirements, it should be free to desist from distributing profits as dividend to the maximum limit required in terms of the provisions in the section and to conserve a portion for utilisation in such developmental programmes. Under the U.K. income-tax law, it is open to an assessee, governed by the corresponding provision, to show to the satisfaction of the Commissioners of the Inland Board of Revenue that the company concerned has not unreasonably withheld any income from distribution and on that basis the assessee would be allowed the benefit of some flexibility in the quantum required to be distributed as dividend.

Apart from introducing an element of flexibility in regard to the quantum required to be compulsorily distributed, there should also be provisions permitting adjustments to meet difficulties of a practical character. In the case of a company having branches functioning in foreign territories, actual difficulties may be experienced in securing remittances from such branches by reason

restrictions on movement of capital or moneys, imposed by the authorities of those countries. The company concerned, under such circumstances, may not have funds in this country sufficient to ensure distribution upto the prescribed limit. In determining the amount for distribution, obligatory charges such as those levied by a Government of a State or by a Local Authority which may not have been fully allowed in computing assessable income of the company, will also have to be allowed. Further, on occasions when it is difficult for an assessee to estimate exactly the assessable income, an opportunity should be given to make up the full 60 per cent. or whatever the prescribed limit.

Under the present provisions again, when the accumulated reserves of such a company, in which the public is not substantially interested, exceed the paid-up capital, the full 100 per cent. of the profits is required to be distributed. This compulsory distribution of the entire profits should not be enforced. If the shareholders of such a company desire further allocation to themselves, the Department should not come in the way of such allocation by arbitrarily insisting on 100 per cent. distribution of profits.

There is also another practical difficulty in administration, which has been noticed. At present, the completion of assessment work takes an unduly long time, and if after a period of 2 or 3 years the company is required to compulsorily distribute the deficiency as determined by the Income-tax Officer, having regard to the items which he considered as disallowables, the company may not be able to find the resources necessary for such supplementary distribution. Therefore, the time-limit, of say 2 years from the date of passing of the Balance Sheet for the relevant period, should be fixed, after which there should be no orders for compulsory distribution.

Sections 42 and 43

We would like to re-state the general case and grievance of the assessee about the extremely unsatisfactory position resulting from the provisions of Sections 42 and 43 of the Indian Income-tax Act as they stand at present. The general complaint is that the provisions in the section have been so administered that Indian exporters who sell goods to foreign buyers and Indian importers who buy goods from foreign sellers, even in cases where such transactions are as between principal and principal, are being treated as agents of non-residents concerned in respect of such transactions and on that basis, are being subjected to tax in respect of profits or gains deemed to have been made by the non-resident. Although we have been assured that the intentions of both the legislature and Government are that actually, the liability of the agent to pay the tax will not arise except where something definitely in the nature of an agency existed, in actual practice, the application and the enforcement of the provisions in the section, it is noted, goes counter to the main purpose and primary intentions of the legislature and Government in making the agent responsible for the tax liability of the non-resident. The confusion and the difficulty have really arisen because the term 'business connection', occurring in the section, has been very literally construed both by the taxing authorities and by some of the High Courts in the country. If a strictly literal interpretation is given to the term, it would appear that even a single transaction between a resident and a non-resident would be deemed as a business connection and on that basis the resident would be called upon to discharge liability as agent, in respect of the tax due from the non-resident. In order to remove the doubts regarding the real intentions of the scope of the liability contemplated by the provisions in question, we had, in the past, indicated the importance of an entire review of the provisions in Sections 42 and 43. We had also drawn the attention of Government to the practical difficulties with which the persons, who were treated as agents of non-residents, were being confronted. It is not possible for such agent, where a non-resident had more than one agent, to know the total income of such a non-resident through the agency of different persons in the country and consequently it is not possible for any such agent to ascertain the tax liability and retain sufficient amount in his hands to meet the liability when the demand is finalised. This view has been confirmed by the observations made by the Chief Justice of Bombay in a recent reference involving interpretation of the sections in question. Moreover, under the existing sections, a resident agent is made liable in respect of income made by the non-resident principal on account of 'business connection'. The expression 'business connection' has nowhere been properly defined. The vicarious liability to which a resident is subjected under the existing provision should be removed and the sections in question should be so amended so that a non-resident principal would be subject to the taxation laws of this country only when he exercises a trade in the Union of India and not merely

with India. In short, the changes required in regard to the provisions in question may be briefly summarised as under:—

- (1) It should be made clear that, firstly, there would be absolutely no tax liability on transactions purely on a principal to principal basis;
- (2) secondly, that the vicarious liability to which a resident is subject under the present provisions, should be removed by providing that a non-resident principal would be subject to the taxation laws of the country only when he exercises a trade in the country, as is the position under the corresponding provisions of the U.K. law; and
- (3) thirdly, in any event, the liability of an agent should be confined to the funds or moneys of the non-resident actually coming into his hands in excess of the commission or remuneration to which the agent may be entitled and where such an agent has no money from such a non-resident at the time of assessment, he should not be held liable for any payment on behalf of the non-resident.

A *bona fide* commission agent or *bona fide* broker should not be considered as an agent for purposes of Section 43.

The Income-tax Appellate machinery to be separated from the administrative machinery

The view that the Appellate machinery under the Income-tax Act should be completely divorced from the administrative side and that towards that end the Appellate Assistant Commissioners should be placed under the administrative jurisdiction of the Income-tax Appellate Tribunal has often been stressed. This view found support from the Income-tax Investigation Commission also. It is a salutary principle that the executives, who are concerned with deciding matters of fact or law, should not themselves sit in judgment on any points arising out of such decisions which are brought up for appellate consideration. The need for reform in the direction of separating the judiciary from the executive has been acknowledged in other spheres and the present suggestion is an extension of the same principle. The experiment begun in 1939 of making the appellate machinery independent of the charging machinery should be carried forward to its logical conclusion and the Appellate Assistant Commissioners should be removed from the control of the Commissioners of Income-tax and the Central Board of Revenue and placed under the Income-tax Appellate Tribunal. "On the principle that not only should justice be done but that it should appear to be done and should inspire confidence in the persons concerned, we think that the present system requires alteration"; in the above words the Investigation Commission supported the public demand for this reform.

Regarding the composition of the Tribunal, we had often in the past stressed that the Accountant Member of the Tribunal should be one chosen from the practising profession. Lately, retired Income-tax Officials are being appointed as members of the Tribunal. This is undesirable and should not be allowed.

Difficulties in the process of income-tax administration

While the importance of enforcing due observance and compliance with the requirements of the law in force from time to time will be readily conceded, some of the causes and circumstances responsible for creating a feeling of oppressiveness in the minds of the assessee as a result of the administrative practices of the Departmental officers require to be gone into. The general complaint is that in the anxiety to augment collections, there is generally a tendency on the part of the Income-tax officers to over-assess. It may be argued that the assessee has the right to press the matter on appeal and get the position rectified. In the meanwhile, the demand is enforced and the assessee is called upon to pay to the full extent of the demand; requests for time for stay of enforcement of the disputed portion are not generally agreed to and even the Income-tax Investigation Commission found it necessary to recommend the insertion of a specific provision conferring a right of appeal for stay of enforcement. If the right to the benefit of stay of recovery of the disputed portion upto the time the appeal is decided is legally recognised, the grievance of the assessee resulting from the denial of this facility would automatically go. The attitude of the officers in applying the penal provisions of the Act also calls for a definite change. The tendency seems to be imposed heavy penalties for even defaults of a technical nature. In applying the penal provisions, the officers should be required to be guided by the larger point of view of corrective action and penalty should not be imposed merely to recover additional revenue to the extent authorised by law. Delay in completing assessments, and delay in passing and settling claims

for refund are other spheres in which complaints of a general nature persist. Unless the law imposes a definite obligation to complete assessment within a short period and to grant refund within a prescribed time-limit, complaints in these spheres will persist. Non-acceptance of accounts submitted by assessee and assessment on the basis of assumed margins, etc., are some of the other general grievances of the assessee. We are mentioning these to emphasize the importance of sustained effort to usher in an era of relationship between the assessee and the department in which the former is encouraged to feel that the law was being administered in a fair and reasonable manner. Often-times the official spokesmen at the helm of the Income-tax Department assert that the law was being administered in a fair manner. The test should be that the public should also share that feeling and on the administrative side the importance of public relation should be sufficiently impressed. In this connection, the Commission may consider the feasibility of creating, at each important regional Income-tax Headquarters, some sort of machinery—may be in an advisory capacity—which could go into the difficulties and complaints in the administrative sphere. In that machinery non-official representatives of accredited organisations should be included. The public should be encouraged to place their difficulties, particularly pertaining to administration, before that advisory machinery, so that the very knowledge that departmental action would be subject to constant informal or advisory review, would be helpful in creating more cordial relations between the departmental officers and the assessee. Greater care in the selection and training of personnel recruited as Income-tax Officers is called for. During the period of the War, the Department expanded considerably and the basis of selection was relaxed. Apart from such Officers having an adequate theoretical knowledge of accounts and trade laws, they should be also given intensive training at headquarter Income-tax Office for a period of not less than 2 years. Again, as accounts in the case of smaller assessee may be maintained in vernacular, the Income-tax Officers should know or should acquire adequate working knowledge of one of local vernaculars. With these preliminary observations, we would proceed to deal with the question *seriatim* :

RESIDENCE

Question 46.—Do the provisions of the Income-tax Act (Sections 4A and 4B) regarding the determination of residence of various assessee, viz., individual, Hindu undivided family, firm, association of persons and company, require any modification? In particular, what is your view regarding the retention of the category described as "not ordinarily resident"?

The principle of taxing a resident assessee on his world income was first introduced by the Indian Income-tax (Amendment) Act in 1939 and the category of "not ordinarily resident" was then brought in as a concession to assessee who were foreigners and who were in the country temporarily for the purpose of their business or vocation. There is no longer any need to continue this special position. The Income-tax Investigation Commission had recommended the abolition of this category of assessee and we are in favour of dividing the assessee for the purpose of tax liability under two broad categories, viz., resident and non-resident.

According to Clause (iv) of sub-sec. (a) of Sec. 4A, an individual would be a resident in India if he has arrived in India during the relevant year and the Income-tax Officer is satisfied that he is likely to remain in India for not less than 3 years from the date of his arrival. According to this provision, an individual who comes to India will be liable to be taxed as a resident if the Income tax Officer is satisfied that he is likely to remain in India for not less than 3 years from the date of his arrival, even though his actual residence in India may be only for a small period. Further, since an assessment may be closed and completed after over 3 years, the Income-tax Officers' finding on the question whether the assessee is likely to remain in India for not less than 3 years from the date of his arrival will be a finding after the event. We, therefore, suggest that this Clause should be deleted.

INCOME

Questions 47 and 48.—Does the definition of "income" [Sec. 2(6C)] require any modifications? Are there any receipts or gains which are not taxed at present, but which, in your opinion, should be taxed and vice versa? In particular, what is your view regarding the taxing of capital gains?

The existing definition of 'income' is inclusive and not exhaustive. In the case of Mutual Insurance transactions, the resultant surplus would not be normally income, whether the transactions are with members or with non-members. But the definition of 'income' makes such surplus liable to taxation as 'income'.

There is no difference between the surplus of a Co-operative Insurance Company and the insurance business transacted by a Mutual Association. Therefore the definition of 'income' should be changed, so as to exclude the profits of a business of insurance carried on by a Mutual Insurance Association.

Taxing of Capital Gains.—We are not in favour of taxing capital gains. The limited experience of the working of the Capital Gains Tax in force from 1947 to 1949 confirms the general view that it has an adverse psychological effect on investments, and it would hamper the free movement of stocks and shares. In fact, the Finance Minister of the Government of India acknowledged these aspects in his speech while moving for the abolition of the levy in 1949. The psychological reactions following the existence of such a levy should not be ignored. During appreciation in capital value on account of temporary factors, there will be disinclination to sell capital assets. In periods of comparative slump, on the other hand, there will be an inducement to sell with a view to claim set-off of loss against other income. In the result, there will be no stable recurring revenue from such a form of taxation.

Question 49.—Have you any comments on the present position re : taxation of profits which accrue or arise abroad, on their repatriation to India?

It is relevant to recall that the 1939 Amending Act substituted accrual of income as the basis of liability in place of the remittance basis previously in force in the case of the foreign income of a resident in this country and thereafter the resident is being taxed on the basis of his world income. Naturally, the foreign income of a resident assessee, after that date, has borne taxation and therefore the amount represented by such profits could be brought by him into the country. Taxation consideration would not stand in the way of the amount represented by such profits being brought to the country, whenever the assessee chooses. There is however, the case of income and profits earned by resident assessee between 1933 and 1939. Even if the assessee wish to bring the same to the country at this stage, they would feel discouraged to do so, because of the fact that the same would attract taxes as soon as it is brought to the country. Government should be alive to the importance of attracting increased capital for utilisation in the country. It would be in keeping with the present objective of assisting the flow of capital if foreign income, profits and gains of Indian residents, made during the period 1933 to 1939 is allowed to be remitted to the country without any liability in regard to tax.

Foreign profits, remitted or brought into India by a person within the first 2 years of his becoming a resident in India, are exempt. The period of 2 years fixed for the purpose of repatriation of foreign profits is inadequate. In view of the various restrictions existing in overseas countries regarding movement of capital outside their limits, it may be impracticable, in many cases, to transfer an assessee's entire resources within the period allowed. We, therefore, suggest that in the first instance, the period should be increased to 5 years and, if it is proved, by reasons of the existence of checks on movement of capital in other countries, that in a particular case the same could not be repatriated within 5 years, the scope of the relief should be extended to subsequent years also, when actually the remaining portion of the foreign profits is brought back into the country.

Question 50.—What change, if any, is called for in the definition of 'dividend' [Sec. 2(6A)]; e.g., in relation to 'bonus shares'?

We do not think any changes are necessary in the definition of 'dividend' in Section 2(6A).

Question 51.—Do the provisions of the Income-tax Act relating to the taxability of non-residents through their business connections in India in respect of income deemed to accrue or arise within the taxable territories (Secs. 42 & 43 of the Income-tax Act) affect adversely the interests of persons engaged in foreign trade? If so, what modification would you suggest in these sections?

We have already, in our preliminary observations, referred to the unsatisfactory nature of the provisions in Sections 42 and 43 and the working of the same. Briefly stated, the changes required are that there should absolutely be no tax liability on transactions purely on a principal to principal basis, that the vicarious liability which a resident is subjected under the present provisions should be removed by providing that a non-resident principal would be subject to the taxation laws of the country only when he exercises a trade in the country and that in any event the liability of an agent would be confined to the funds or moneys of the non-resident actually coming into his hands.

Question 52.—What modification would you suggest in the definition of 'agricultural income' [Sec. 2(1)] to

avoid the contingency of the same income being taxed by the Central Government as well as the State Governments, e.g., in respect of income from forests, dividends from agricultural companies, etc.?

Income derived from land would be treated as agricultural income for the purposes of the Indian Income-tax Act only when the land is assessed to land revenue in the taxable territories. The justification for the income-tax exemption thus is that the land and the revenue therefrom has borne a prior tax or rate. In the past, the spirit of the above exemption was fully respected for income-tax purposes and dividend income from agricultural undertakings was excluded from income liable for taxation. Unfortunately, the above position has been upset by certain recent legal decisions on the ground that dividend income was not directly received from land. Without going into the fine legal distinction involved in the above decision, we would urge that the position should be made clear by suitably amending the provisions in the Income-tax Act, so as to confer exemption on such dividend income.

Question 53.—Are you in favour of integrating agricultural income with non-agricultural income for rate purposes? If so, which of the following methods would you advocate :—

- (i) Aggregation of agricultural and non-agricultural incomes only under the State Acts ;
- (ii) Aggregation of agricultural and non-agricultural incomes only under the Central Acts ;
- (iii) Aggregation of agricultural and non-agricultural incomes both under the State and the Central Acts?

Please discuss the administrative, constitutional and other problems that are likely to arise if any of the above alternatives is adopted.

Question 54.—Would you recommend the abolition, by a suitable amendment of the Constitution, of the distinction between agricultural and non-agricultural incomes and the taxation of both types of income, aggregately under a Central Act?

Agricultural income is, in terms of the provisions of the Indian Constitution, out of the sphere of Central taxation. In the past, suggestions were made that the exemption of agricultural income for purposes of Income-tax should be discontinued. The Ayre's Committee had also recommended that agricultural income might, at any rate, be taken into account for the purpose of determining the rate at which tax on the other income should be computed. Apart from the constitutional difficulties which by themselves are valid and substantial against agricultural income being aggregated or taken into account for rate purposes, certain recent trends of legislation in the sphere of tenancy rights and land tenure call for a new approach to the problem. For agricultural income, naturally the exemption limit will have to be kept at a comparatively high level. The land revenue payable will also have to be taken into account. Lately, agrarian reforms in the States, wherever they have been undertaken, indicate distinctive trends. Larger holdings are being prevented and compulsory distribution of holdings is being attempted. The large agricultural land-holder, with substantial resources in the shape of recurring yield will, perhaps, be no longer there. In the light of these developments, such additional taxation on agricultural income, as may be necessary, will have to be confined through an increase in the land revenue rates or, as is already being done in some of the States, by a separate agricultural income-tax leviable by the State. It is difficult to envisage State authorities surrendering their constitutional right over agricultural income and as long as the two types of income, viz., agricultural and non-agricultural, are under the jurisdiction of two taxing authorities, any proposal for aggregation, whatever be its fiscal justification, is not easy of realisation.

Question 55.—Is the treatment given to irregular and fluctuating income in the present law satisfactory? In particular, should any changes be introduced—

- (i) to average income over a number of years where receipts are irregular and fluctuating ;
- (ii) to spread lump sum receipts over a number of years ?

Section 12AA of the Income-tax Act, which is a new provision inserted by the Finance Act, 1953, has recognised the principle of spreading over a period of years income of an irregular and fluctuating character. But the provision is confined to specific cases, viz., royalties or copyright fees for literary or artistic work. There are other types of income of this nature. Some general provision which would enable such income being spread over, in an appropriate manner, is called for. In the case of a film undertaking, for example, the receipts in a particular year, for right of exhibition of a film for a period of years, will have to be suitably adjusted. Similarly, lump sum payments on termina-

tion of employment in the shape of gratuity or compensation for loss of employment should not, reasonably, be liable to taxation in the year of receipt as income during that year. Income from long-term contracts, or cumulative dividends, paid at a particular point of time should also be suitably adjusted for purposes of tax liability. Premiums received for lease of property should not be considered as income wholly received in the year of receipt, but should be spread over. Therefore, the law may include a general provision to permit of the same

EXEMPTIONS

Question 56.—Do you think the present provisions regarding exemption of charitable and religious trusts need any modification? If so, in what respects?

The provision in Section 4(3)(i) secures exemption from tax liability for income held under Trust for religious or charitable purposes. To entitle the benefit of the exemption, the source of the income should be from property held under Trust or which is the subject of Trust. Till recently property was deemed to include business carried on by a Charitable Trust where the income is exclusively used for religious or charitable purposes. This point of view was supported by a decision of the Lahore High Court. Government, however, thought it fit to withhold the benefit of the exemption for income derived from business by undertaking an amendment of the Income-tax Act in the year 1953. We feel that this amendment was not justified. Even if the source of income is business, so long as the income is exclusively used for the purpose of charity, the same should be eligible for exemption in the same manner as income from property held under Trust are exempt. The position should be rectified and the status quo ante should be restored.

Another point which requires to be noted, in this connection, is that ordinarily the exemption under this provision will be available only if the income is applied for charitable purposes within the taxable territories unless the Central Board of Revenue makes an order that the relief may apply even if the income is applied to charitable purposes outside the taxable territory. The restriction that in order to obtain exemption the income should be applied within the taxable territories is likely to create hardship in the practical application of the relief. In the case of charitable trusts which, from traditional times, have been awarding scholarships to Indian nationals for higher technical studies in foreign countries, the withdrawal of the relief, on the ground that the income is not being spent within the taxable territory, would amount to a hardship. The law may, therefore, be suitably amended so as to make it clear that where the amounts are spent for purposes or objects ensuring ultimately to the benefit of the country or to the nationals of the country in general, the same would be allowed, notwithstanding the circumstances that the amount may have been spent outside the country.

Question 58.—Are you in favour of continuing the concessions given to new industrial undertakings under Section 15(C) of the Income-tax Act? Have initial and extra depreciation allowances made the concessions practically infructuous? If so, what are the directions in which the provisions of this section should be modified?

Section 15(C) of the Indian Income-tax Act provides a measure of relief for new industrial activity, in that income-tax shall not be payable by a new industrial undertaking on so much of the profits or gains as do not exceed six per cent. on the capital employed in the undertaking for a period of years commencing from 1st April 1948 to 31st March 1954. We are in favour of the relief and encouragement being continued. The grant of initial and extra depreciation allowance in no way affects the justification and need for the above relief. While higher initial depreciation allowance affords some measure of financial assistance, it must be pointed out that such allowances, in effect, are only in the nature of interest-free loans to the undertaking in the initial period against the mortgage of its future depreciation allowance as the total of the allowances, including the initial slab, will not be permitted to exceed 100 per cent. of the cost of the plant and machinery concerned. Therefore, the system of increased initial allowances cannot be considered as anything in the nature of effective relief. New manufacturing concerns are encouraged in a similar manner by provision for a tax-free period under certain circumstances in other countries also. The question of further modifications and relaxations in favour of new industrial undertakings in the provision under the section may well be examined. For instance, the restriction now in force that the relief shall be available only in the case of an undertaking employing more than 20 workers or 10 workers in the case of industries worked by power, as the case may be, requires to be reconsidered and there need not be any limit with reference to the number of

employees. Again, the benefit is intended to be available only to industries started between the years 1948 and 1954; on the other hand, the provision may be general and whenever new industries are started, the relief should be available. For the purpose of calculating the profits to be exempt from tax to the extent of 6 per cent. per annum on the capital employed in the undertaking, initial depreciation allowed for new property, machinery or plant should not be taken into consideration.

Question 59.—*A suggestion has been made that banking profits of foreign branches of Indian banks should be given concessional treatment for tax purposes in order to encourage the opening of branches abroad. What are your views?*

We are in favour of the proposal that banking profits of foreign branches of Indian banks should be entitled to concessional treatment for tax purposes in order to encourage the opening of branches abroad. We would also suggest that the principle of affording concessional treatment in respect of profits of foreign branches should be extended to shipping and insurance companies.

Question 60.—*Should any liberalisation be made in the present limits of exemption from tax of life insurance premia and contributions to provident funds?*

Exemption from tax of amounts paid as life insurance premia and contributions to provident funds was intended to encourage thrift and to ensure that a person during his working period made savings in that form which would reasonably provide for himself and his family after active life. The limits prescribed under the Act are no longer adequate having regard to the reduction in the purchasing power of the money and the general increase in cost. There is, therefore, a justifiable case for an upward revision of these limits. At present, the total of the allowances under Section 15 in respect of insurance premia and under Section 58 in respect of contributions to provident funds should not exceed 1/6th of the total income of the assessee or Rs. 6,000, whichever is less, and in the case of a Hindu Undivided family, 1/6th of the total income of the assessee or Rs. 12,000, whichever is less. Normally the rate of contribution for purposes of recognised provident funds is 8 1/3 per cent. by the employer and 3 1/3 per cent. by the employee. Thus the limit of 1/6th of the total income is, as a matter of fact, normally absorbed by the provident fund contribution alone and in effect the relief by way of exemption for life insurance premia does not operate. We, therefore, suggest that the limit should be raised to 1/4th of the total income or Rs. 10,000, whichever is less, with corresponding adjustments for Hindu Undivided family.

We have elsewhere suggested that the present system of two distinct levies, such as income-tax and super-tax, should be consolidated. If, however, it is proposed to retain the two kinds of levy, life assurance premia and contributions to provident fund should be exempt from super-tax.

While on this, we would also like to draw pointed attention of the Commission to the discrimination in the basis of arrangement connected with tax relief in the matter of contributions to recognised provident funds as between provident funds for employees of Government and statutory organisations and provident funds for persons in private employment. The details regarding the difference in the basis of the relief are briefly indicated here below:—

Provident funds governed by Provident Fund Act, 1925.

1. The employers' contribution and the interest accumulations to the credit of the Provident Fund are not taken into account in computing the total income of the employee for purposes of income-tax liability.

2. Exemptions allowed:

(a) Insurance premia and employee's contribution to the extent of 1/6th of total income, (i.e., including private income, allowances, etc.) or Rs. 6,000 whichever is less [Sec. 15(1) and (3)].

(Thus in an 8 1/3 per cent. Provident Fund 1/12th of the total salary income is available for relief on account of insurance premia in addition to 1/6th of private income.)

(b) Whole of interest is exempted.

(c) Repayment of Provident Fund at the time of retirement or resignation—exempted unconditionally (4th proviso to Sec. 7).

Private Provident Funds recognised under the Indian Income-tax Act.

Under Section 58E of the Indian Income-tax Act, both these items are taken into account in computing the total income of the employee.

Exemptions allowed:

(a) Insurance premia and employee's and employer's contributions to the extent of 1/6th of the total income (i.e., including private income, allowances, etc.), but including employer's contribution and interest on Provident Fund) or Rs. 6,000 whichever is less [Sec. 58F(1)].

(Thus in an 8 1/3 per cent. Provident Fund there will be no margin for relief on account of insurance premia, unless the employee has got private income [Sec. 15(1) and (3)].

(b) Interest upto 1/3rd of the annual salary provided it is not allowed at a rate exceeding 6 per cent. per annum [Sec. 58F(2)].

(c) Exempted subject to conditions set out in S 58G (4th proviso to Sec. 7).

Apart from the injustice in treating the private section of the society on a differential basis, a large issue of policy is involved. In effect, the present position amounts to a lower basis of taxation for income earned by Government servants. Is such a preferential treatment ethically correct? We, therefore, urge that the provision in the Income-tax Act is suitably amended so that all recognised provident funds, including provident funds for private employees, are treated on a uniform basis for purposes of tax relief.

ALLOWANCES.

Question 61.—*(i) Do you favour the grant of larger depreciation allowances to assist industry to finance the considerably increased costs of replacement assets? If so, how and in what form should they be given—*

(a) by larger depreciation allowances on new assets;

(b) by revaluation of existing assets;

(c) by treating the excess of replacement cost over original cost as revenue expenditure;

(d) by any other method?

(ii) What is the justification for assistance from public resources to certain classes of taxpayers only by way of covering partially the excess of replacement cost over original cost of old assets?

(iii) In case adequate justification exists for assistance by Government in the form of tax concessions to meet the situation, what safeguards should be prescribed to see that the funds so made available are utilised for the purposes for which they are intended?

(1) We have already, in our preliminary observations stressed the importance of liberalising the basis of depreciation allowance so as to assist industry in its programme of renovation and replacement. The specific suggestions which might be considered are:

(a) Excess sale proceeds of machinery, under Section 10(2)(vii), should not be treated as income liable to taxation. The law should provide that such amount should be free from taxation provided the same is kept as reserve and utilised only for replacement purposes.

(b) The principle of tax-free replacement reserve should be recognised. It should be open to a company to set apart a certain percentage of the profits made by it in industry every year as a reserve to be utilised for purposes of replacement. Such reserves should be free from tax. Here a safeguard might also be included. If subsequently such accretions to the special reserve fund are not utilised for replacement purposes, the same should be liable to tax. In the alternative, the rebate of 1 anna now available in respect of undistributed profits ploughed back into the industry should be raised to 2 annas.

The grant of larger depreciation allowance on new assets alone will not prove to be a solution so long as the sum total of such allowance does not exceed 100 per cent. Income-tax authorities should be empowered to grant higher depreciation allowances in all cases, where the circumstances warrant the granting of such higher allowances.

The procedure of revaluation of existing assets may be helpful, but the point as to how that revaluation is to be applied for other purposes, viz., for purposes of the accounts of the company, requires to be examined in greater detail. Revaluation of existing assets should be done only by a body of experts.

Assistance in the shape of special loans from statutory lending organisations for financing replacement is another form of relief which may be considered.

(c) The proposal that excess of replacement cost over original cost may be treated as a revenue expenditure would afford material relief, but the point arises whether the profits of an undertaking in a given period would be sufficient to allow this relief being made available in a particular year. If the principle of carry-forward is to apply and that is for a fairly long period for such

excess of expenditure, then a solution in that direction may prove helpful.

Question 61.—(ii) and (iii) The questions here are based on the assumption that something in the nature of special favour is being shown to industrial undertakings. On the other hand, it should be viewed from the aspect of rectifying the damage done by a lacuna in the previous position. In the period of the war and immediately thereafter when the price structure of plant and machinery was progressively rising, industry was taxed to the full extent without making due allowance to the need for the future requirements as indicated by the rising trends in prices of plant and machinery. If in those years, those in charge of framing the tax policy had thought it fit to look ahead and allowed industry increased provision for future needs and requirements, the question of any special assistance at this juncture might not have arisen. Moreover, the problem has also to be viewed in a wider perspective. After all industrial asset is an asset of vital national importance. It is in the larger interests of the country to preserve that asset. If new industry is to be stimulated by the grant of concessions or other forms of assistance for preserving the general economic policy of the State, there is greater reason for some special consideration for assisting existing industry to preserve their productive capacity unimpaired in regard to their needs for replacing the existing wornout equipment.

The funds made available by tax concessions for assisting replacement should be strictly used for that purpose. If they are not so used, the tax relief should automatically go. Government might also prescribe other safeguards preventing mis-use or wrong use of such funds.

Question 62.—*Are any changes called for in the classification of assets for purposes of depreciation, rates of depreciation and methods of computing the allowances?*

In 1939 the law was changed whereby the written-down value method for purposes of grant of depreciation allowance was introduced. When the change in the method was announced, we had expressed the view that the depreciation allowance granted under the written-down value system would not be the actual depreciation and that in a period, when wear and tear was greater, the allowance for depreciation would be less. From time to time, organisations representing special branches of industry have placed before Government suggestions regarding changes in classification and the rates at which depreciation should be allowable for particular class of assets. Government may be requested to refer all such suggestions to an expert body like the Council of the Institute of Chartered Accountants of India. The task of reviewing and revising the classification and the rate structure may be decided upon after such an expert scrutiny.

Question 63.—*Should any tax concessions be given to encourage development of mineral resources? If so, what form should they take? In particular, should depletion allowance on wasting assets be allowed? How should it be computed for different kinds of assets you have in view?*

The principle of special encouragement for operations on wasting assets has now been recognised and taxation systems of other countries provide special reliefs or concessions for operations of that character. Under the English Income-tax Act, two kinds of allowances are granted. An initial allowance on the capital expenditure incurred in the acquisition of wasting assets is granted and an annual allowance calculated by reference to the output, it is understood, is also granted. The Taxation Enquiry Commission should recommend a provision for relief for undertakings involved in exploiting wasting assets like mines, oil-wells, etc. The details of the basis on which such allowances should be granted may be formulated and settled in consultation with organisations representing such mining and other interests.

Question 64.—*In what form would you provide for personal and family allowances—*

- (i) *exempting the first slice of income from tax; or*
- (ii) *providing specific allowances for family and dependents? In the case of (i), do you consider that the first slice Rs. 1-1,500—should be revised? In the case of (ii), what treatment would you give to the Hindu undivided family?*

In regard to taxation of personal income, it must be remembered that what is taxed is not the residue available after meeting what is essential for sustaining the life of the person. In short, the scheme of taxation is not the taxation of the surplus as such, but of the income as a whole. The case for specific allowance for personal income is, therefore, on strong grounds. The relief should be provided by a combination of both the methods, viz., increasing the slice which is exempt from

liability for taxation and providing allowances on the lines of similar allowances granted under taxation systems in other countries.

Regarding the tax-free slab, the present limit of Rs. 1,500 should be increased to Rs. 2,500. Allowance for children relief and allowance for dependents relief are allowances in force under the U.K. law. A specified allowance of say, Rs. 500 for each child should be available to a tax-payer for children under 18 years of age, living at any time during the assessment year with him. Such relief may be limited to four children. In the case of children over 18, allowance at the same rate should continue in the case of those who are receiving full-time instruction at a university, college or other educational establishments. In the case of a Hindu undivided family, allowance should be computed with reference to the number of children of each co-parcener in the family.

Question 65.—*Should the present law regarding admissible expenses [Section 10(2)] be altered? If so, please indicate, with reasons, the items of expenses (i) which are not now admissible but, in your view, should be admissible and (ii) which are now admissible, but, in your view, should not be admissible.*

Section 10(2)(xv) of the Act provides that any expenditure, not being a capital expenditure or personal expenditure, incurred wholly or exclusively for the purpose of business should be an admissible deduction. The complaint of the tax-paying public has been that while the responsibility for carrying on the business and earning the income which results in tax liability, is that of the assessee, the right of determining how far and to what extent the expenditure, claimed in connection with that business is admissible, is vested in the assessing authority. The general feeling is that the right is exercised vexatiously and not in a manner which takes due note of the practical realities of the circumstances connected with the business of the assessee concerned. All items of expenditure which, in fact, have actually been incurred and about which proof has been furnished to the assessing authority should, as a matter of course, be allowed. The Income-tax Officer should be empowered to go into the reasonableness of the expenditure only for purposes of ascertaining its *bona fides*, and not otherwise. There is then the case of expenditure for which proofs in the shape of vouchers or receipts cannot be submitted. It is common knowledge that in many trades there are secret commissions and other forms of special payments. As far as such commissions and special payments are concerned, they should be allowed within a reasonable limit.

Expenditure of an exploratory or developmental character should also, as a matter of course, be allowed. Illustrating the point, in efforts to explore new markets and possibilities of fresh or increased business, businessmen have sometimes to undertake extensive tour. In the year in which such tours are undertaken, the same might result in substantial expenditure. The compensating factor will be that, in due course of time, the same would result in additional business which, in turn, would bring additional income liable to taxation. The complaint is that the assessing authorities are inclined to take a limited and narrow view of such expenditure and they allow the same only if, as a result of such travel, in the accounting year, there has been a substantial addition of new business and new income. Expenses incurred for advertising should be considered as revenue expenditure and allowed as an admissible item.

The cost of income-tax appeals and references should be an allowable expenditure. Revenue expenditure incurred before business began should be allowed in the first accounting period. Legal costs on the acquisition of a lease or right should be allowed for the period of the lease.

Any expense or loss incurred in providing benefits for employees should be deductible. Any abortive expenditure should be deductible as an expense of the year in which it is incurred. Expenses incurred in successfully defending any criminal proceeding against an assessee in connection with the business should be allowed. We would here like to urge the importance of the law making it clear that all payments which have to be made as a consequence of the decisions of authority having legal force, should, as a matter of course, be allowed. Instances have happened where Tribunals, appointed by Government under the Labour Laws, have awarded certain payments in the matter of bonus, gratuity, etc., and where the Income-tax Officers have questioned such payments on the ground of either being excessive or not relating to the period for which the assessment was being made. In the case particularly of awards resulting in gratuity payments, the effect of the disallowance can be easily imagined. It must be realised that the employer has no choice in the matter, who has, perforce, to incur the expenditure when a properly constituted authority awards the payment.

If it is felt that such payments do not fall under Section 10(2)(xv), special provision should be made to make it clear that payments consequent upon decisions having legal character, should be allowed as items of revenue expenditure deductible in arriving at the assessable income. An attempt should be made, so as to be of guidance to the assessee, to codify items of expenditure which would normally be deemed as admissible deductions for the purpose of computing income for tax liability under Section 10. In the preparation of such a list, perhaps, legal decisions in the past in regard to points of dispute involving admissibility of particular items of expenditure would be helpful.

Rate Structure

Question 66.—(a) Are you in favour of combining income-tax and super-tax into a consolidated levy?

(b) What are the merits or demerits of such a step from the point of view of (i) assessee, and (ii) administration?

(c) Are you satisfied with the degree of progression in the present rate structure (both income-tax and super-tax) especially in regard to its economic effects?

(d) In case you consider a change is necessary, what alternative rate structure would you recommend?

(e) Should the rate of surcharge levied under Article 271 of the Constitution also be graduated?

(a) In our preliminary observations earlier, we have already expressed our considered view that the present position of two separate levies under the nomenclature Income-tax and Super-tax is not rational and serves no special purpose. Both the taxes are taxes on income and such direct taxation on income, as may be considered necessary for budgetary and other considerations, should be by a consolidated levy.

(b) The combined rate will show clearly the exact proportion of the tax burden on a given income. Administratively also, all the complicated calculations are avoided. From the point of view of the assessee, reliefs which are now not applicable in respect of super-tax will be readily available. Income from interest on Government Securities which are free of income-tax, is, for instance, not free of super-tax. Similarly, for super-tax purposes the exemptions in respect of charitable donations under Section 15B are not available. Earned income relief is also not available for super-tax purposes. The allowance in respect of insurance premium is not extended to super-tax purposes. Dividend income is included for purposes of computation of super-tax liability although such income might have borne both income-tax and Corporation Tax in the hands of the company.

(c) The degree of progression in the existing rate structure is very unsatisfactory. The maximum rate of taxation being applied at a comparatively lower level of income, the residue available at the disposal of an assessee, after meeting the tax demand, also compares unfavourably with the position under the taxation systems in other countries. Illustrating the point, on an assessed income of Rs. 5 lakhs, the balance available to an Indian assessee would be just over 24 per cent., whereas in Canada it is over 43 per cent. and in the U.S.A., over 51 per cent. The inevitable consequence is that the object of savings assisting capital formation to subserve the needs of an expanding economy is not facilitated.

(d) In the absence of detailed break-up figures of the aggregate income under the different slabs, it is difficult for the Committee of the Chamber to suggest a detailed rate structure indicating the rates of varying tax for the different slabs of income. They have already expressed themselves in favour of a combined tax structure, under which there will be only one kind of direct taxation on personal income. They have also urged that having regard to the imperative necessity for making the tax structure such as would leave in the hands of the assessee a residue of income adequate to stimulate capital formation and investment support, the maximum rate of personal taxation should be suitably lowered and the level of income at which such a maximum rate would be applicable adequately raised. Bearing these considerations in view, they are of the considered opinion that the maximum combined rate of tax should not, in any event, exceed 9 annas in the rupee and that the said maximum rate should be applicable to slabs of income of Rs. 2½ lakhs and over.

(e) We are not in favour of anything like a surcharge being levied on the income-tax rate. However, if, for reasons of an exceptional character such as meeting the needs of the Central Exchequer in an emergency, Government find it necessary to impose a surcharge, the same may be on a percentage basis of the existing rate; such percentage will automatically bring about a graduation in the different slabs of income. A graded

surcharge as such will be very difficult from the administrative standpoint. While on this, we would also like to stress that surcharges, whenever introduced for reasons of an emergency character, should be strictly of a temporary duration, viz., for the period of the emergency, for which the revenue therefrom is intended to be. Thereafter, the surcharge should automatically go. In any case, no surcharge should be allowed to remain in force continuously for a period of more than two years.

Question 67.—Have you any change to suggest in the exemption limit for individuals (Rs. 4,200) and for Hindu undivided families (Rs. 8,400)?

The exemption limit for individuals was increased this year from Rs. 3,600 to Rs. 4,200 and from Rs. 7,200 to Rs. 8,400 in the case of Hindu undivided families. The main consideration, which weighed with the Finance Ministry in recommending the raising of the limit was that, by so doing, the total number of assessee would be reduced by over 70,000, resulting in administrative convenience. The loss to the Exchequer was estimated to be less than Rs. 1 crore. We desire that the matter should be reviewed from another standpoint. The exemption limit is intended to ensure that the tax liability should accrue only after providing the necessary margin for meeting the minimum requirements of an assessee. In providing for such minimum needs, the effect of the present conditions on the cost of living should be given due importance. There is a strong case for an upward revision of the limit and we suggest that the same may be increased to Rs. 6,000. As regards the Hindu undivided family, the Income-tax Investigation Commission had recommended that the non-taxable maximum should be twice that prescribed for individuals and in the case of Hindu undivided families having more than four co-parceners, the non-taxable maximum should be three times that obtaining for individuals.

Differentiation

Question 68.—(a) Are you in favour of a distinction being made between earned and unearned incomes? What is the economic justification for such a distinction?

(b) Is the present definition of "earned income" in Section 2(6AA) of the Income-tax Act adequate in this respect or would you suggest any modification?

(c) Should the quantum of relief now afforded be extended or reduced? If so, to what extent?

(a) The distinction between earned and unearned incomes for purposes of tax liability may be continued. Such a distinction is obtaining elsewhere and is generally justified on taxation principles. Earned income is supposed to represent the result of personal initiative and effort and on that basis, is considered as entitled to special encouragement.

(b) We have no particular suggestions to make in regard to the definition of earned income. The present position seems to be satisfactory.

(c) Earned income relief is limited to one-fifth of the income or Rs. 4,000, whichever is less. Once the principle of earned income being eligible to a concessional rate is accepted, there is considerable force in the point of view that the relief should be extended to a larger sector. We suggest that the limit may be raised to Rs. 6,000.

Earned income relief should also be available in respect of income of a minor partner assessed in the hands of his father.

Miscellaneous

Question 69.—Have you any changes to suggest regarding the principles followed in valuing stocks or a business for assessment purposes?

We have in the past generally expressed ourselves in favour of stocks being valued at market value or cost, whichever is lower. What is, however, of importance is that there should be some uniformity in the system of valuation; the method of valuation should be regulated by accountancy principles. We suggest that the Council of the Institute of Chartered Accountants of India may be requested to go into this aspect from the point of view of accounting principles and prescribe a formula for adoption.

Question 70.—Do you consider that any change is called for in the method of assessment of the Hindu undivided family? If so, in what respects?

For income-tax purposes, the Hindu undivided family is being regarded as a single unit and assessed through the Manager or the *Karta*. We are in favour of the same position being continued. However, we are of the considered view that the Income-tax authorities should readily accept the Hindu joint family as having partitioned when such a partition is effected by an unequivocal declaration of partition on the part of the

co-parceners and the Department should not insist on partition by metes and bounds. As regards assessment, incidentally it may be mentioned that formerly there was a higher exemption limit in the case of the Hindu undivided family for purposes of super-tax. There is justification for an increase in the exemption limit if super-tax as a separate tax is to continue, although we have, earlier in our views, expressed ourselves in favour of a consolidated levy.

Question 71.—Should exemption from income-tax be allowed in respect of voluntary surrender by managing agents of the whole or a part of managing agency commission? What safeguards should be laid down against misuse of such a provision?

Managing Agency commission voluntarily surrendered either as a whole or in part should not attract tax. The amount represented by such commission having not been actually received by the Managing Agents, the question of any tax liability does not arise. The fear that a provision, that the exemption for commission surrendered is likely to be misused is far-fetched, as no Managing Agent is likely to surrender his commission except where in the larger financial interest of the company as such, such a self-denying option on his part is necessary. In any case, the test for tax liability should be whether the income has been actually received or not.

Question 72.—On what basis would you suggest that double income-tax avoidance agreements should be concluded between India and other countries?

The entire position in regard to the balance of advantage by India entering into agreements for avoidance of double taxation should be reviewed by an expert body. There is a general feeling that in the present context, the balance of advantage would be for the nationals of the other countries as Indian nationals claiming relief in respect of taxes paid to other taxing authorities would be comparatively small. The Central Board of Revenue might have the statistics about the comparative position and the extent to which Indian nationals, on the balance, are benefiting by the arrangement. If on such an overall analysis the general arrangement about bilateral agreements for avoidance of double taxation is not found suitable, the Indian tax law should substitute the same by a system of unilateral relief, i.e., our Exchequer should give relief to the nationals of this country to the extent of the smaller of the two taxes paid.

Question 73.—Is the present law relating to determination of 'bona fide annual value' of property and deductions allowed from it satisfactory? If not, please give any alternative proposals you have in this respect.

We would here like to draw the attention of the Commission that the entire basis at present obtaining for taxation of income from property requires to be reviewed. The amounts paid by way of Municipal Property Tax and Urban Immovable Property Tax are not being considered as items of expenditure allowable as a deduction for computing income liable to tax, in the result the property owner has to pay tax on what may be regarded as a notional income which has no relationship to the income actually accruing to him. The reasonableness of the claim for the allowance of such taxes was recognised by Government and in the Budget proposals for the year 1948-49 a provision for relief in respect of such payments was included. Unfortunately, the proposal was not pursued due to legislative exigencies. The issue of these items of expenditure being disallowed was also the subject-matter of an appeal before the Supreme Court and the Court in its judgment decided that what was paid by way of Municipal Property Tax and Urban Immovable Property Tax would be permissible deductions. Government subsequently chose to amend the provision of the Act in question so as to exclude from the scope of 'annual charge' any tax paid in respect of property and the relief secured to the assessee on the basis of the Supreme Court decision was rendered inoperative. We are mentioning these circumstances to reinforce the case for a categorical recognition that Municipal Property Tax and Urban Immovable Property Tax should be included in the expression 'annual charge' and on that basis taken into account for arriving at the income from property in respect of the *bona fide* annual value for purposes of tax liability.

Another anomaly operating in the sphere of taxation of property is that there is no provision for allowance for depreciation on buildings. Grant of depreciation is at present confined to property used for business. It is an acknowledged fact that all properties suffer in value by depreciation and there must be a regular provision for the grant of depreciation allowance for property for calculating tax liability.

It is also relevant to point out that charges for collecting rents and repairs have risen substantially.

The present allowance of one-sixth of the annual letting value is no longer adequate to meet these charges. Instead, we suggest that expenses actually incurred for such purposes should, as a matter of course, be allowed.

Income from property should not be assessed on a notional basis. The actual income should be ascertained and the assessment should be made as under Section 10 of the Indian Income-tax Act.

Question 74.—Is any change required in respect of provisions relating to carry-forward of losses? Are you in favour of allowing losses to be carried backward in case of cessation of business?

The Millard Tucker Committee which went into the question of reforming the Income-tax Law of the United Kingdom have recommended that carry-forward of business losses and set-off against subsequent profits should be available without time-limit. The feasibility of a similar facility being introduced here may be examined. Another limitation under the existing provisions, which cannot be reasonably justified is that carry-forward and set-off is available only against the income from the same business. This restriction is leading to vexatious results. Just as the liability of an assessee is determined by reference to the totality of his income, the relief in subsequent years should also be adjusted in relation to the total of his income from all business. The Finance Act of 1953 introduced another arbitrary element, in that speculation losses would be allowed to be carried forward and set-off only against profits or gains from speculation business and not from any other business. The distinction implied in the above arrangement is unjustifiable and will lead to anomalous results. We are of the considered view that this distinction should be removed.

The Millard Tucker Committee again have recommended that in the case of cessation of business it should be possible to carry back a loss incurred in the last year of the business and set it off against the assessments on that business for the three preceding years. The introduction of a similar facility here may be considered.

Question 75.—Do the provisions relating to the payment of advance tax under Section 18A of the Income-tax Act need any modification?

The system of advance payment was conceived as a war-time measure and was mainly intended as a check on the then existing inflationary condition as also to assist the ways and means position of Government. Even then we had expressed ourselves strongly against the proposal. The emergency having ended, there is no longer any justification for continuing the system of advance payment. The present arrangements are also found to be very inconvenient from the point of view of the assessee. It is difficult to estimate, in advance, every quarter, the likely income or profit position with reference to that quarter or prospectively for the year as a whole with any degree of accuracy. Particularly in a period of declining activities and trade recession, the expedient of advance collection of taxes will impose an avoidable strain on the financial resources of the assessee. Another great handicap is that there is no incentive for the Department to expedite the work of assessment. After the system of advance payment came into force, assessments are being kept pending indefinitely. After Government introduced the system of payment of tax dues in the form of advance deposits, the need for finance is no longer a compelling factor to expedite assessments. The removal of the system will, naturally, call for greater attention to the revenue needs of Government and the work of completing assessments will come to be expedited. At the same time, to facilitate the requirements of revenue, we suggest that the provision may be substituted by providing for the compulsory payment of the tax dues within a period of three months from the filing of the return, the tax liability being determined on the basis of the income shown in the return.

Question 76.—Do the principles underlying the assessment under Section 34 of the Income-tax Act need any modification?

The change effected in the position relating to reopening of assessments under Section 34 by the amendments made in 1948 is considered as having vested in the Income-tax Officers more discretionary powers which would enable them to reopen assessments even on mere suspicion. There should be some finality in the procedure and basis of assessments. Under the previous position, an Income-tax Officer could reopen an assessment only on the basis of definite information that income, profits or gains chargeable had, in fact, escaped taxation. There was, thus, a check on the arbitrary exercise of the right of reopening. The Income-tax Officer would be obliged to satisfy the assessee that he was acting on definite information or data. At present he would be in a position to reopen the assessment even if there is any reason to believe that the income has

escaped assessment. We are strongly in favour of restoring the old position under which the right of reopening should be exercisable only on the basis of definite information about escapement.

Question 77.—*What measures would you suggest for simplifying the procedure of assessment in order to reduce the cost of compliance with tax regulations?*

The procedure of assessment requires to be considerably simplified. In the first place, the Form of Return should be made more simple. The present Form has become very cumbrous and together with the Notes and Instructions, confuses an average assessee. The Central Board of Revenue should enlist the assistance of the Council of the Institute of Chartered Accountants of India for framing a simple form. The process of assessment should be expedited and towards that end, the feasibility of a provision that an assessment and the tax liability thereunder would come to be time-barred if the same is not completed within a period of two years instead of the present period of four years from the date of the submission of the return, may be examined. Mistakes of a formal or clerical character should be allowed to be immediately rectified. The Income-tax Officers concerned should be easily accessible to the assessee and should, instead of trying to find faults and mistakes in the Return and the records of the assessee should consider it as part of their duty to guide and assist the assessee with a view to the early completion of the assessment formalities.

Question 78.—*It has been suggested that the Appellate Tribunal should have powers to enhance assessments in the same manner as Appellate Assistant Commissioners have. What is your opinion?*

We are against any proposal for vesting in the Appellate Tribunal powers to enhance assessments. As a matter of fact, it is the assessee who generally would go in appeal against the quantum or amount of the assessments made either by the Income-tax Officer or the Appellate Assistant Commissioner. Further, the Tribunal is the final authority on questions of fact and no appeal or reference can be made from a decision on a question of fact. This being the position, there is no justification for suggestion that the Tribunal should be empowered to enhance the assessment.

Appellate Assistant Commissioners should also not be empowered to enhance the assessment. The present powers in that regard should be removed.

Taxation of Companies and Shareholders

Question 79.—*Do you recommend that an element of progression should be introduced in the corporation tax?*

We are against the levy of Corporation Tax as a separate tax. Joint-stock companies also should be liable to pay only one form of taxation on income and that should be the income-tax. As, in the case of companies, the ultimate liability of the shareholders would again be determined in the hands of the shareholders, the rate of taxation for the company as such should continue to be at a fixed basis without any progression or gradation.

It might be suggested that since Corporation Tax is an exclusively central source of taxation, a change in the above direction would lead to difficulties of a constitutional character, and that the central share of the yield from direct taxes would be affected. The constitutional distinction was, perhaps, with a view to facilitate ultimate distribution of the revenue from direct taxes. Necessary adjustments could be made by revising the basis regarding distribution between the Centre and the States. At the moment, the distribution is on the basis that 60 per cent. of the yield from Income-tax and Super-tax goes to the divisible pool, Corporation Tax being completely absorbed by the Centre. On the abolition of the Corporation Tax, the percentage for the purpose of the taxation pool may be revised. The States also will not suffer in the process for the obvious reason that the additional resources accruing from the Estate Duty will, in its entirety, go to the States.

While on this, we would like to mention in passing that if the Corporation Tax as a separate tax is continued, there is no longer any justification for denying to the individual shareholder the right of revision, in appropriate cases, in respect of tax paid on his behalf by the company in the shape of Corporation Tax as is the case for purposes of income-tax. Both the taxes are taxes on income and the shareholder should be entitled to the necessary adjustment in respect of the Corporation Tax paid on his behalf by the company.

Question 80.—*Would you advocate different rates for different types of corporate enterprises, e.g.—*

- (i) small industries;
- (ii) cottage industries;
- (iii) private limited companies or what may be termed proprietary companies;
- (iv) holding companies?

We are not in favour of different rates for different types of corporate enterprises. The rate structure should basically be uniform and, if necessary, the feasibility of relief by special concessions or rebates for such cases may be examined.

Question 81.—*There is a demand for the exemption of inter-corporate dividends from corporation tax. Do you consider this justified and, if so, why?*

If our suggestion for making the levy on joint-stock enterprise into a consolidated tax is accepted, the question of exemption of inter-corporate dividends from corporation tax would not arise. If, however, the corporation tax continues as a separate feature, then there is considerable force in the demand for the exemption of inter-corporate dividends from corporation tax, as otherwise, there would be double taxation of the same income at different stages.

Question 82.—*Do you think that any special provisions are necessary for the assessment of—*

- (a) banks; and
- (b) investment companies?

Do existing rules relating to assessment of insurance companies, especially mutual insurance associations, require any change? If so, in what respect?

(a) The business of banking has certain special features. As a credit institution, in a banking undertaking it would be part of prudence to provide adequately for future contingencies. The bank should, therefore, be encouraged to build up reserves for bad or doubtful debts as also for depreciation in investments. Banks, naturally, have to carry a large portfolio of investments. Allocations to such reserves should be allowed for tax purposes. In the case of the business of Banking, income under different heads should not be treated separately for tax purposes. The aggregate income, including income from property and other kinds of investments, should be treated as income from same business, so that there may be no difficulty for purposes of carry-forward and set-off of losses under different heads.

(b) At present the income derived by an investment company from dividends of other companies is exempt from super-tax liability. We have already indicated the desirability of introducing a rate structure under which super-tax as a separate tax will go. If that position is accepted, some form of concession in tax treatment for investment companies will have to be granted. Among other reliefs, the question of tax-free allocations reserved for depreciation in the value of investments may be specially considered.

The existing rules governing assessment of Insurance companies require to be modified in the following directions:—

(a) Regarding life insurance companies, re-insurance commission should be treated as a reimbursement of expenditure already incurred. It should not be treated as incomes under the schedule.

(b) Under Rule 4 of the Schedule where the assessment is made under Rule 2(b) on the basis of the annual average of the surplus disclosed by an actuarial valuation for an inter-valuation period exceeding 12 months, no credit should be given in terms of Section 18(5) for the tax deducted at the source in the preceding year. Where there is a valuation for five years and the assessment is made for three years only for that valuation and credit is given at an average tax deducted during the valuation period for three years only, as there is another valuation for three years which have been the basis of assessments thereafter, credit for tax deducted at source to the extent of 2/5ths in respect of five years' valuation is lost to the company. The company should not be deprived of credit of tax already deducted at source to the extent of 2/5ths.

(c) For purposes of carry-forward and set-off of loss under Section 24(2), Life and Fire Departments are treated as separate business so that the profit earned in any particular department could alone be set off against the loss of that department carried forward from the previous year. The two departments should not be treated as separate.

(d) Expenses for travelling, etc., in connection with opening of a new branch should not be disallowed. In this connection, it may be pointed out that the Allahabad High Court in the case of Hindustan Commercial Bank Ltd., held that expenditure incurred in connection with opening of new branches were not capital expenditure and were, therefore, allowable deductions. The High Court observed that by reason of opening of new branches, the out-turn of the business might have increased on which the assessee was liable to pay tax, but it could not be said that there has been any such acquisition of an asset which would amount to all the expenses being classed as capital expenditure.

Regarding General Insurance companies, the demand often placed before the authorities for allowing them the facility of building up additional reserves, requires to be sympathetically considered. Under the present arrangement 50 per cent. of the annual income is allowed for reserve for unexpired risks for Fire and miscellaneous policies and so far as Marine insurance is concerned, 100 per cent. is allowed. Insurance interests have represented that the experience of the working of this arrangement has not been satisfactory and there must be some flexibility in regard to the allowance for reserves. Possibly, the Indian authorities have followed the arrangements under the English law for the purpose of the above relief. But the position in the two countries is not on a strictly comparable basis. The English companies have accumulated reserves to stand by on occasions of periods of special risks and hazards. Moreover, under the English law the Marine accounts are not closed for a period of one year, but for periods of two years at a time on the basis that marine covers and claims take a longer time in the process of settlement. In respect of fire insurance also, the insurers are entitled to place before the authorities the special circumstances on the basis of which they claim higher allocations for reserve and the law is made flexible to allow such special claims wherever the basis and justification for such special treatment are supported by the circumstances of the case. It is, therefore, desirable that increased allocations for reserves of General Insurance companies should be recommended.

In the case of Life Insurance companies, there is also the demand often placed before the authorities that 100 per cent. of the adjusted surplus allocated for the benefit of the policyholders should be allowed as a deduction. The present position is that only 4/5ths of the surplus reserve for policyholders is so allowed. There is no justification for this restricted relief as the surplus really belongs to the policyholders although held by the company till the time of actual distribution.

The question of encouraging insurance companies to build up reserves against depreciation in value of their investments should be sympathetically considered. Any amount carried to such a reserve should be allowed, as a matter of course. The assessing authorities should not consider that the allowance should be dependent on the fact whether depreciation has actually taken place or not. It should also be made clear that if the depreciation is wiped out by a rise in value in a subsequent year within or after the same inter-valuation period, though in such a case if the subsequent appreciation has not been taken credit for in the accounts or in the actuarial balance sheet, the depreciation written off should be allowed and should not be subsequently adjusted.

Earlier we have already indicated our view that Mutual Insurance Associations should be placed on the same basis as Co-operative Societies for the purpose of tax liability.

We would here like to make some observations on the question of the tax liability of mutual associations although the same is not strictly covered by the question under discussion. For purposes of tax liability the accounts of mutual associations, working for the benefit of their members, are divided into two parts. The subscription income is treated as voluntary contributions from members and not liable to tax. The income derived by the association from other sources, viz., investments, property, etc., are made taxable. Hardships arise in the fact that the allocation of expenditure is not quite rational. In the case of many associations, a good part of the expenditure is met out of income from other sources, say, from property or from income from investments. Although the activity of the association as such is not treated as commercial by isolating the income derived by it from non-member sources, more tax is collected from such associations than would be the case if the overall position is taken. To illustrate the arbitrary nature of the working of the present arrangement, we would mention the instance of our Chamber. In the Chamber we are conducting a Monthly Journal. The Monthly Journal results in an annual loss of a fairly large sum, say, over Rs. 20,000. On the ground that the Journal is primarily intended for the members of the Chamber, this loss is treated as a non-commercial loss. At the same time, there is a small income of Rs. 5,000 or 6,000 by way of advertisements. This advertisement income is taken as commercial income and aggregated with the other commercial incomes for tax liability after allowing a small proportion for expenditure in the printing of advertisements. Even if the Journal as such is treated as an expenditure for membership, the overall financial result of the Journal is not being taken for computing the tax liability. The allocation of expenditure as between the taxable and non-taxable activities should be a little more realistic and adjusted to practical requirements of the case. The associations should also have the option to request the department to compute their tax liability

by the overall position, i.e., if the activities of the Association as such result in a deficit or in a smaller surplus, the assessment should be with reference to that overall position and not merely with reference to the balance of position calculated with reference to the commercial activities as such.

Question 83.—Do you think that differentiation should be made between distributed and undistributed profits of companies for tax purposes? If so, on what grounds? What change would you suggest in the present quantum of differentiation in favour of undistributed profits? Should the concession in future be restricted to particular industries?

If the tax concession in favour of undistributed profits is allowed to continue as at present or in a modified form, what measures would you suggest to ensure—

(a) that retained profits are not used as a device by shareholders of private limited companies to evade super-tax;

(b) that retained profits are actually applied for productive purposes?

In particular, are the provisions of Section 23A of the Income-tax Act satisfactory? If not, what changes would you suggest?

The differentiation in treatment as between distributed and undistributed profits of companies for tax purposes is justified. It encourages efforts to consolidate the position of the company and will help ploughing back part of the profits for purposes of expansion. In short, it is a recognised method of financing future requirements of capital. We would suggest that the amount of rebate may well be increased. It is at present one anna; the same may be increased to two annas. We are not in favour of the concession being restricted to a particular industry. It should be available in all cases of undistributed profits.

We do not consider that any special safeguards are necessary to ensure that retained profits are actually applied for productive purposes. If, however, Government wish to arm themselves with powers, it may be provided that if at any time retained profits are used in the process of distribution, or used for purposes other than that connected with, or are not ploughed back into, the activities of the companies, the same would be liable to taxation.

Regarding the anomalies resulting from the present provisions in Section 23A, we have already, earlier in our observations, made detailed suggestions.

Question 84.—Do you think, in view of the fact that profits distributed by a company are subjected to corporation tax, it is appropriate that they should also be charged to super-tax in the hands of shareholders? If not, what are your suggestions in this regard?

In the first place, we have recommended that the system of subjecting companies to two taxes under different nomenclatures should be discontinued. If corporation tax, however, is to continue as a separate levy, the dividend income which has already borne corporation tax should not be subject to super-tax in the hands of the shareholders.

Question 85.—Would you consider that industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies should be required to contribute, from their earnings in the way of income-tax or in other ways, to general revenues?

The State is increasingly entering into spheres which were traditionally recognised in the past as meant for the citizen. In that process, the resources of the State are employed in competition with the resources of the citizen. Conditions of such competition, it is reasonable to suggest, should be even and equal, and in fields of such trading activities the State should not be entitled to any benefits of a special or concessional character. If State-owned business undertakings are exempt from the obligation to pay tax, it would mean that we are creating unequal conditions of competition. In a mixed economy, it is quite obvious that in the same sector there would be manufacturing or trading units owned by private enterprise as also by the State. While the concept that, as in the trading activities of the State, the element of profit-making is absent, the same should be entitled to tax-free consideration might have been deemed as reasonable in the past, in the existing context of affairs, under which the State is making incursions into the sphere of organised trading or manufacturing activity, there could be no longer any justification for continuing the exemption of profits of such activities from taxation. The inequity of any difference in the basis of treatment for taxation purposes is quite obvious and will lead to results of an undesirable character.

Such tax liability should not be confined to vocations when the commercial or industrial activities of the State are a separate structural unit under the framework of the Indian Companies Act or any other special legislation. The liability should accrue even where the State concerned carries on commercial activities, more or less, on a departmental basis. The State Governments are now operating large transport and other services. Some of the Governments have been actively carrying on day-to-day trade. Some such trading activity has resulted in large profits. It is but proper that in respect of such trading activities, the States concerned should be placed on a position of par in the matter of tax liability with private enterprise.

Evasion and Avoidance of Tax

Question 86.—*What measures would you suggest for the greater use of the services of Chartered Accountants for assisting in the determination of the taxable income of assessee? What obligations should be placed on a Chartered Accountant when he certifies a statement of accounts of an assessee for purposes of income-tax assessment? In particular with a view to minimising evasion of tax, would you recommend that the certificate of a Chartered Accountant should invariably accompany the return for business income over a certain limit? If so, would you suggest that a form of certificate should be prescribed indicating the scope of the check that should be exercised by Chartered Accountants who render the certificate mentioned above? Do you agree that fees payable by assessee to Chartered Accountants for such certificates should be restricted to a schedule to be prescribed by Government?*

Normally the accounts maintained and presented by the assessee should be accepted subject, of course, to the departmental verification. The use of the services of a Chartered Accountant for assisting the determination of taxable income of an assessee should be on an entirely optional basis. If the assessee chooses to enlist the services of a Chartered Accountant, then the account presented by the Accountant should be accepted as a matter of course. In cases where, having regard to the smallness of the income or other connected factors, the assessee does not think it feasible for him to enlist the services of a Chartered Accountant, such enlistment should not be enforced and the accounts produced by him, subject, of course, to such departmental scrutiny, should be accepted.

The question of standardising the certificate to be given by a Chartered Accountant along with the return may be examined in consultation with the Council of the Institute of Chartered Accountants of India.

Question 87.—*What changes would you suggest in the present law relating to the representation of assessee before Income-tax authorities (Section 61) in order to ensure—*

- (i) *effective representation of assessee at reasonable fees;*
- (ii) *a minimum level of proficiency on the part of representatives regarding the subject of income-tax law, rules and regulations?*

The Income-tax practitioners should be encouraged to form themselves into an effective organisation and to prescribe a code of conduct for the profession. In the case of the Accountancy profession Government have taken steps which have resulted in the professional activities being regulated under the guidance of a recognised Institute. Similarly, the accredited Association of the Income-tax Practitioners should be taken into confidence and through the aegis of the Association, Rules framed for governing the code of conduct for the Income-tax Practitioners. In Bombay there is the Chamber of Income-tax Consultants, representing collectively the Practitioners at this end. The feasibility of the formation of similar organisations at all income-tax centres and entrusting the Association with the work of enforcing and maintenance of proper standards by the practitioners may be considered.

Question 88.—*Will it assist in checking evasion if the names of the persons who are penalised for concealment of income are published?*

We are not in favour of the introduction of the practice of publishing the names of persons penalised for concealment of income. The main object of any such step is to hold the person to ridicule. Such a procedure smacks of a form of medievalism in inflicting punishment. Again, for the offence of concealment, the assessee concerned would be punished in terms of the provisions in the law, either by way of fine or imprisonment. Therefore, the publication of the names and the consequent ridicule would amount to the infliction of an additional punishment.

Question 89.—*Do you think that the present practice of excluding, from taxable profits, perquisites given to employees of business undertakings results in con-*

siderable loss of revenue? If so, please state the perquisites you have in mind, and how they should be dealt with for the purposes of taxation?

Normal perquisites given to employees in the shape of allowances for specific purposes should be excluded for computing tax liability of the employer, unless in cases where the Income-tax Officers have reason to believe that the allowances granted are disproportionate to the nature of the duties performed by the employee, and constituted a deliberate attempt to fritter away the resources of the employer and to reduce the tax liability. The assessing authority has adequate powers to go into the details of such allowances and to determine the quantum which could reasonably be allowed. Beyond that there should be no general provision for excluding all perquisites.

Question 90.—*In the case of a company under liquidation, what steps, if any, would you suggest for safeguarding payment of tax dues before any payments are made to shareholders?*

Under the law, as it stands, tax claims have always a prior or preferential claim in liquidation and bankruptcy proceedings. We do not think that a debt to the State should have priority over other preferential debts such as wages to workmen, labourers, rent, etc. In any case, no payment to shareholders, even under the existing law, is possible before all these preferential claims are met. No additional provision seems necessary.

Question 91.—*Do you think that, in order to minimise evasion and avoidance of tax, there is a case for conferring larger powers on income-tax authorities? If so, what further powers should be given to them? In particular, should powers to search premises and seize documents and books of accounts be given to Income-tax authorities? If so, what is the lowest grade of officer on whom you would confer these powers?*

We are of the considered view that the powers vested in the assessing authorities under the existing provisions of the Act are sufficient and adequate to prevent any avoidance of tax. Recently these powers have been added by provisions enabling enforcement of submission of a wealth statement under certain circumstances as also enabling the impounding of books of accounts of the assessee under certain circumstances. Even otherwise, there is a general feeling that the attitude of the assessing authorities towards the assessee calls for a reorientation. Powers to enter and search premises, seize documents and books of accounts should not be vested in the Income-tax machinery. It must be remembered that assessee are not criminals as nothing incriminating has been found against them. They should be entitled to the normal immunity enjoyed by the average citizen and if on suspicion or prejudicial information the Income-tax authorities enter the premises of an assessee and conduct a search, the information about such a development will do irreparable harm to the standing and credit of the assessee concerned and with all the emphasis at our command, we would submit that the Commission should discount the idea of such inquisitorial methods in income-tax proceedings and administration.

Question 92.—*What precautions are necessary and possible to prevent the creation of an artificial legal entity—a trust or a private limited company or a partnership, especially family partnership—either for avoiding payment of income-tax or for fractionating of income to escape higher rates? Would you recommend the use of penalty rates of tax to minimise such practices?*

A clear distinction must be made between evasion of tax and avoidance of tax. Evasion of tax arises when there is a deliberate attempt to defraud revenue; avoidance, on the other hand, is a process of adjustment of the financial affairs of the assessee in such a manner as to reduce tax liability within the framework of the provisions of the law. In a recent judgment of the Bombay High Court, the Chief Justice, Mr. M. C. Chagla, succinctly dealt with this aspect in the following words: "A citizen is perfectly entitled to exercise his ingenuity so to arrange his affairs as may make it possible for him legally and lawfully not to pay tax, and if his ingenuity succeeds, however reluctant the Court may be to acknowledge the cleverness of the assessee, the Court must give effect to the letter of the taxation law rather than strain that letter against the assessee." In another judgment, Chief Justice Sir John Beaumont gave his considered opinion: "Anyone is entitled so to conduct his affairs within the law as to avoid incidence of taxation, and if a man finds that he will suffer less in taxation by carrying on business in partnership with his mother rather than his wife, he is entitled to select his mother. But the partnership must be a genuine partnership." We submit, therefore, that the underlying presumption in the question is not justified. As long as the law otherwise permits it, it should be open to the assessee to create a Trust or

to form themselves into private limited companies or enter into partnerships in order to secure a reduction in the tax liability. There is nothing illegal or immoral about it. No special checks in the shape of penalty rates of tax to meet such a situation would be justified.

Recovery

Question 93.—*In the case of a registered firm, would you advocate recovery of unrealised tax of any partner from the firm as such or from other partners?*

In the case of a registered firm, under the existing provision and practice, tax liability does not attach to the firm as such but to the individual partners. The tax liability is also computed with reference not merely to the share of income from the partnership business as such but after aggregating the other income of the individual partners. There would be no justification to fix the liability on the firm for such liability is not merely with reference to the profits accruing from the business but will be dependent on the general liability of the partner as an assessee. On the same basis, there would be no justification to recover the tax dues of the defaulting partner from the remaining partners. Government should rely on the normal powers of enforcement vested in them by the provisions of the Act.

Question 94.—*Are present arrangements relating to recovery of income-tax adequate? Would you advocate the Income-tax Department having a separate machinery for enforcing the recovery of arrears of tax?*

We presume that in respect of tax deducted at source under the special provisions of the Act, the existing provisions and arrangements regarding recovery have not resulted in any difficulty. No change is called for in the same.

In regard to the recovery of arrears, the powers conferred at present are adequate and easily enforceable. On a certificate from the Income-tax Officer, the Collector of the area recovers the arrears as in the case of arrears of land revenue. No other legal formalities have to be completed. In the process of recovery, the Collector is entitled to sell all the assets of the assessee including movable property, distrain crops, cattle, life-stock, etc. The extreme method of enforcement of arrest and imprisonment is also not ruled out, except in the case of an assessee who is a lady. We do not think it is necessary for the Income-tax Department to have a separate machinery for enforcing recovery of tax dues.

Question 95.—*What provisions should be made to ensure timely collection of tax from private limited companies? Do you consider that liability for payment of tax in such cases should be placed upon shareholders of the company in proportion to their shareholding?*

Private limited companies are as much a legal entity as public limited companies. The principle of limited liability implied in any type of joint-stock undertaking equally operates in the sphere of private limited companies. The underlying idea is that an individual shareholder in a private limited company, as is the case for a shareholder in a public limited company, is liable only to the extent of his unpaid share capital. No other liability attaches to him personally in respect of the affairs of the company. This principle should not be violated by any exceptions made for purposes of the Income-tax Law.

Earlier we had suggested that in place of the present requirement regarding advance payment, a procedure under which the assessee pays the tax due on the basis of the return within three months after the submission of the return be introduced. If such a procedure is introduced, within a short time of the closing of the account period, the assessee would be obliged to pay his tax dues. Chances of loss on account of the present abnormal delays in completing assessments would be obviated and no other special precaution seems to be necessary.

Question 96.—*If income from any property is included for assessment purposes in the hands of a person other than the ostensible owner, would you agree to the tax so assessed being also made recoverable from such property?*

Income-tax is more or less in the nature of a personal liability and is not a liability attached to the property as such. It should be enforced against the person assessed.

General

Question 97.—*What concrete measures should be taken to improve the relations of the Income-tax Department with assessee, especially in regard to—*

(i) *provision of free advice to small assessee on the followings points:—*

(a) *maintenance of accounts in a form acceptable to the Income-tax Department; and*

(b) *matters such as filing returns of income, claiming refunds, facilities for tax payment, expeditious disposal of assessments, etc.;*

(ii) *provision of information on various matters relating to assessment proceedings, such as disposal of refund applications, adjournment applications, examination of records, etc.;*

(iii) *arrangement of work so as to obviate the necessity of assessee or their representatives having to wait in Income-tax Offices for unduly long periods; and*

(iv) *securing the largest measure of agreement on facts between the assessee and the department at Income-tax Officer level?*

The Commission should concentrate on efforts to improve the general relations between the Department and the assessee. This is an aspect which has caused good deal of concern and dissatisfaction in the past. Apart from creating good Public Relations machinery at each Income-tax Headquarters, which, among other things, will give free advice to assessee, assist them in maintaining accounts in proper form and assist them in the matter of discharging their formal obligations such as filing returns, claiming refund, etc., there should be created at each Income-tax Headquarters a High Power Advisory Body to whom aggrieved assessee could go to represent their grievances and difficulties. Besides the Commissioner of Income-tax and other departmental officials, the Advisory Body should include representatives of accredited associations. The knowledge that departmental action is likely to come up for review in such a manner would in itself have a salutary effect in not only increasing administrative efficiency but also in improving the relations between the Department and the public. The superior officers should be easily accessible to the average assessee and when they have any complaint or grievance against a subordinate, same should be looked into expeditiously and the apprehension that the audacity of the assessee in seeking to present the matter before the Commissioner would entail the wrath of the official and further resulting harassment should be removed. All Income-tax Officers should also undergo training in developing personal relationship and treatment of the public.

The arrangement for the reception of assessee in the Department should be improved. They should be treated in the same manner as a business firm would treat its constituents. After all, they are the main contributors to the revenues of the State on which the Department is sustained. Provision of adequate accommodation for sitting together with minimum amenities should receive greater attention. In the matter of appointments with Income-tax Officers, greater care should be taken to see that those called for interviews have not to wait indefinitely. The present practice of a chain of interviews on a particular day with the previous interview overlapping the time for the successive interviews should end. Interviews should be planned on a basis that assessee are not obliged to wait indefinitely. In any case, if it is found that an assessee called for interview could not be attended to immediately, he should be informed of the same and given choice of an alternate appointment on a subsequent day.

Question 98.—*What changes would you suggest in the existing arrangements relating to—*

(i) *issuance of notices;*

(ii) *simplification and filing of returns;*

(iii) *levy of penalties;*

(iv) *recovery of tax; and*

(v) *appellate procedure and machinery, particularly with reference to administrative control over Appellate Assistant Commissioners?*

(i) *Issue of notices.*—Notices issued should clearly indicate the requirements which the assessee is expected to fulfil. Omnibus demands should be avoided. Notices should also not be issued as a matter of course and in a routine manner. Only on occasions where any provision had to be complied with a formal notice should be deemed as necessary.

(ii) *Simplification and filing of returns.*—We have already indicated the need for simplifying the form of the return. In any case, for returns for personal income or for salaries, a simple form without all the details now included in the form should be evolved.

The request for extension of time for filing of returns should generally be favourably considered except where such requests are made repeatedly.

(iii) *Levy of penalties.*—The Income-tax Officers should be impressed to bear in mind the corrective aspect of penalty. Penalty should not be levied to the extent authorised by the law merely for the purpose of augmenting revenue. For offences of a technical

nature, the tendency to inflict penalty should be discouraged.

(iv) *Recovery of tax.*—Requests for time for payment of tax dues or facility of payment by instalments should normally be sympathetically considered. As mentioned earlier, when the tax demand is subject to an appeal, payment of the disputed portion of the tax should not be enforced. The present discretion to stay recovery is not being used to the benefit of the assessee and a specific legal right conferring such stay, except on occasions where the Income-tax Officer has reason to believe that the stay would result in frittering away of the assessee's tax resources, should be granted.

(v) *Appellate procedure and machinery.*—The appellate machinery should be completely divorced from the administrative side. The Appellate Assistant Commissioners should be removed from the control of the Commissioners and the Central Board of Revenue and placed under the Appellate Tribunal.

When a point has been decided in appeal, the Department should give the benefit of the decision for subsequent assessments instead of compelling the assessee to go in appeal on the same point. Similarly, benefit of the decision should also be extended to other assessee, where identical or similar points are involved.

There is another administrative aspect which has been the cause of bitter complaint. The frequent transfer of Officers results in considerable practical hardship to the assessee. When a new Appellate Official takes up a case left uncompleted by his predecessor, everything has to start *de novo*. When a case, therefore, has been taken up and heard by an Appellate Officer, he should not be transferred until such time as orders on the case are passed.

The proviso to sub-sec. (1) of Sec. 30 of the Indian Income-tax Act provides that no appeal shall lie against an order under sub-sec. (1) of Sec. 46, i.e., from an Order imposing a penalty, unless the tax has been paid. Very often, this provision creates great hardship in that the Appellate Assistant Commissioners before whom appeals from an order imposing penalty are filed, refuse to hear the appeals on the ground that the tax has not been paid. The provision should, therefore, be amended, and an appeal from an Order under Sec. 46(1) should be heard by the Appellate Assistant Commissioner and such hearing should not be conditional upon payment of the tax due.

Question 99.—(a) Do you think that undue delay occurs at present in the course of assessment proceedings? If so, what do you attribute this to and what are your suggestions for remedying this?

There is a general complaint that assessment proceedings are unduly delayed. One reason for the delay, it is understood, is that many times Income-tax Officers are reluctant to act on their own and have developed the practice of previous consultation with superiors, viz., Inspecting Assistant Commissioners, and deal with the matter only after obtaining their guidance. The assessment proceedings are the primary responsibility of the Income-tax Officers and they should not normally be encouraged to look to the Inspecting Assistant Commissioners for guidance in every case. Similarly, the Inspecting Assistant Commissioners should not interfere in day-to-day assessment work.

Another factor generally contributing to the delay is the practice of calling for a variety of documents and papers. The Income-tax Officer should *prima facie* satisfy himself about the correctness of the returns and should not be unduly punctilious about the submission of detailed mass of documents and papers.

The difficulty about transfer of Officers during the pendency of an assessment is another contributing factor. Instances have happened in the past when after an assessment had been under the scrutiny of an Income-tax Officer for a period of months there was a transfer, the entire proceedings having to start *de novo*. Here also, there should be a general practice under which a transfer should take effect only after the official concerned had disposed of the work actually in his hands.

To obviate delays, a system of check-up of progress of assessment may be introduced. If within a period of three months after the submission of return, the assessment in respect of an assessee is not completed, the Income-tax Officer should be under an obligation to submit a diary of delayed cases stating the reasons for such delay.

At present, an assessment has to be completed normally within four years. The period of four years is too long. It should be provided that if the assessment is not completed within two years from the date of submission of the return, same would be deemed as time-barred. Such a check would have a salutary effect.

Question 99.—(b) In order that delays of the kind mentioned above do not appreciably affect collection of a substantial portion of the tax due, should any special concessions be provided to assessee to induce them to make advance payment of tax?

We have expressed ourselves against the system of advance payment of tax. On the other hand, we have suggested that a procedure might be introduced under which the tax liability estimated on the basis of the return submitted by the assessee should be payable within three months from the date of the filing of the return.

Special Business Taxes

Question 100.—What, in your opinion, would be the circumstances which would justify the levy of Excess Profits Tax or special business taxes?

We are not in favour of the levy of special taxes like the Excess Profits Tax or special business taxes. The experience of the working of these taxes has confirmed us in our view that such forms of taxes are not desirable and suitable. In periods of excess profits, normally the Exchequer gets a larger share by way of income-tax. When a uniform and consolidated structure of taxation is evolved, all such special levies should not be attempted. In an emergency, there is provision for the levy of a surcharge on general rates of taxation, the proceeds accruing entirely for the Central Exchequer. Beyond such an additional levy, and that too strictly confined to meet the conditions of an emergency, there should be no additions to direct tax in the form of Excess Profits Tax or special business taxes.

Death Duties

Question 101.—What are your main reactions to the Estate Duty Bill at present before Parliament?

The Estate Duty Bill has since been passed by the Houses of Parliament. We had submitted a detailed Memorandum of our views and suggestions when the Bill was under discussion. We do not propose to cover the entire ground again for the purpose of the present Questionnaire. All that we would like to say is that in the context of the overwhelming need for assisting capital formation, the levy of this duty and at the rates now announced will have a depressing effect on new or increased economic activity. More than anything, we also fear that psychologically the Bill will encourage a tendency for dissipation of resources instead of assisting conservation of resources for developmental purposes.

Question 102.—Would you in the matter of rates of levy differentiate between self-acquired property forming the estate of a deceased and property inherited by him?

Obviously, when the Questionnaire was framed, perhaps, the Commission were under the impression that the Bill would not have become law before they had completed their recommendations. As the position stands at present, the rates structure has already been adopted and in the rates structure the distinction has not been recognised. However, viewed objectively, there is considerable force for introducing the distinction on the same analogy as the distinction for purposes of income-tax between earned income and unearned income. As, however, for the present, the discussion of the merits of such a distinction would be merely one of an academical character, we have no desire to pursue

PART III.—COMMODITY TAXES (CENTRAL & STATE).

CUSTOMS

The Indian Customs Tariff, like many other modern tariffs, is very complex. The system of levying duties on importation originated in this country in the year 1875. Temporarily between 1882 and 1894 no duties were levied. The financial exigencies, however, led to the reimposition of the Customs Duty in 1894. A brief historical survey of the growth of the tariff may not be out of place.

From 1894 till the period of the First World War, the general rate of import duty was 5 per cent. Cer-

tain items like Railway materials and machinery were free of duty. Items like liquor and tobacco, capable of yielding higher revenue, were subjected to higher rates. After the outbreak of the First World War, there were three important stages of increase in the rates, viz., in 1916, 1921 and 1922. In 1916 financial exigencies necessitated a general revision. The general rate was increased from 5 per cent. to 7½ per cent. and the duty-free list was also curtailed. The list of items bearing higher rates was added to.

In 1922 Government was confronted with a heavy deficit in the budgetary position and among other things, the general rate of import duty was further raised to 11 per cent. From that year onwards a schedule of luxury goods like motor-cars, silk goods, watches, etc., was introduced bearing duty at a higher percentage. The general rate was again increased from 11 per cent. to 15 per cent. in 1922. From that year onwards wide breaches were made also in the principle, which till then existed, of uniformity in rate with small exceptions.

In 1921 the first Fiscal Commission recommended a policy of discriminating protection. They also recommended the introduction, as a general principle, of exemption from duty of raw materials used in industries and low rates of duty on semi-manufactured goods entering processing activities. During the years following, a policy of discriminating protection was followed and two types of duties, viz., revenue and protective, were in force. Many duties that were protective in effect were important as producers of revenue also to the extent that the level of the levy was not high enough to shut out imports. Similarly, duties levied for revenue purposes, in most cases, furnished an incidental measure of protection. During the inter-war years, the country greatly reduced its dependence on foreign sources of supply in certain consumption articles such as cotton textiles, matches, soaps, sugar, iron and steel and a few chemicals. Thereafter, during the period of the Second World War, imports declined firstly due to non-availability of supplies and secondly due to restrictions necessitated by currency considerations. The cumulative effect was a drastic fall in revenue on account of customs.

Since customs duties had been an important source of Central revenue before the Second World War and since alternative sources were not adequate to meet the increasing demands on account of increasing expenditure, Government had to tap intensively customs duties by increasing the rates. In 1941 there were certain increases on specified items. In 1942 this was followed by an overall surcharge over the whole field of import duties to the extent of 1/5th of the rates in force. These steps resulted in increasing the yield, but it was only from 1944/45 that the revenue position recovered substantially as a consequence of freer flow of imports.

After the war, relief in respect of customs duty was given on certain items particularly on raw materials required for industry and on plant and machinery. The duty on the latter was reduced from 10 per cent. to 5 per cent. except in the case of certain items, in which corresponding locally manufactured plant and machinery required to be protected. In the post-war years, articles which are generally considered as luxury items were singled out for higher taxation with a view partly to discourage their consumption. In 1950 the general rate of duty stood at 30 per cent. There was a group of items selected for specially high duties, another group subjected to protective duties, and yet another group subjected to low duties and a few items entirely free. As a cross division of the revenue duties a group of items carried preference for the U.K. and other British Colonies.

The current import tariff schedule consists of 22 sections, incorporating over 520 items, all separately mentioned. Out of this, a group of 317 items is subjected to *ad valorem* duties and the rest are specific. Again 413 are revenue duties, 92 preferential and 128 protective. At present the general rate of duty stands at 31½ per cent. *ad valorem*. Concessions on the lines of the GATT are granted to 116 items. The internal classification of the tariff is on the basis of affinity or attributes. Goods are listed according to their stage of manufacture, viz., raw materials, finished goods, etc., or as to their derivations, viz., animal, vegetable, mineral products, etc., or in line with some other technical description or use.

The best way to study the justice or the effect of the import duties is to classify the taxed articles under four broad categories, viz., necessities, luxuries, raw materials and capital goods and to analyse and compare the proceeds from each class. Such a classification may not give a definite idea of the exact burden on the various income groups. Nevertheless, the broad picture given by this classification will be instructive.

The *de facto* burden of a tariff is measured by the ratio of yield of customs duties to the value of imports. Such a basis may not be helpful in giving a correct picture about the level or the height of the tariff, but is a rough indication of the effect of the tariff as a whole. The *de facto* burden before the years of depression, i.e., for the years 1926/27 to 1928/29 was estimated at 16.63 per cent.; during the years of depression, i.e., 1929/30 to 1933/34, the same was 26.8 per cent. In the period of recovery 1934 to 1936/37 it was 30.1 per cent. In the pre-war years 1937/38 to 1939/40 it was 26.4 per cent. In the war years 1940/41 to 1945/46 it was 31.9 per cent. In the post-war years 1948/49 to 1951/52 it has been estimated at 17.5 per cent.

The fact that the *de facto* burden has gone down notwithstanding the substantial increase in the general level and the increase in rates of import duty on many of the items goes to show that while the character and composition of our imports might have undergone substantial changes, the level of the tariff has not been such as to increase the overall burden. The obvious inference is that our imports have expanded in spheres in which the rates of duty are comparatively lower. In respect of those items on which the higher rates of duty were charged with the combined view of either restricting consumption and increasing revenue, the results achieved have been, perhaps, according to plan. While there may be a feeling of disappointment that the rates of duty on certain items in use by particular sectors importing the same are high, it cannot be contended that the present level of tariff has, taken as a whole, a regressive effect on the volume of imports. Similarly, the comparative position in regard to *de facto* burden also would lend support to the point of view that in the search for wider coverage or increased revenue the sphere of import duties offers reasonable possibilities.

The general consideration which should weigh in the matter of future adjustments in our import tariff should obviously be that raw materials required for our industries should invariably be free of import duty; semi-manufactured goods entering any such manufacture or imported for processing activities here should bear only nominal rates of duty. In cases where such raw materials or semi-finished articles are partly used for manufacturing purposes and partly for other purposes, a system of refund of duty in the case of users importing the same for manufacturing purposes should be introduced; in regard to import duty levied on raw materials used in manufactured goods where the levy, at the raw material stage, is dictated by wider considerations, there should, at any rate, be an arrangement under which refund of duty paid on the raw materials used in the finished products subsequently exported should, as a matter of course, be granted. The level and rate of import duty on items which are in the nature of essentials of life should be kept comparatively low. The present system of preferential rates in respect of imports from particular countries should be reviewed and no such concessional treatment should be allowed unless on the basis of a corresponding *quid pro quo*; where imports have to be restricted to reduce internal consumption, such checks should be by a combination of both quantitative control and levy of import duties so that such essential imports, as may be necessary, are not penalised by unduly high rate of import duty.

Export duties were an integral feature of our early tariff policy and were levied generally at a small *ad valorem* rate on most of the exports, certain articles being specifically exempt. Although the levy was mainly justified on grounds of revenue, the principle was regarded as unsound and a consistent policy of abolition of export duties was pursued from 1867 right up to 1916. In the period just before the First World War, export duty was levied only on one item, viz., rice. The need for additional revenue during and after the First World War led to a revival of taxes on exports. In 1916 jute and tea were brought within the purview of export duties and in 1919 tax was imposed on exports of hides and skins. The duty on hides and skins was intended as a measure of protection to the Tanning Industry to check exports in raw form.

Prior to the Second World War export duties of importance were levied by this country only on raw jute and jute goods. In the post-war period Government imposed duties on a number of articles with a view to bringing about an equilibrium between the internal prices and the export prices and with a view to having a share in the difference between the two prices for the State Exchequer. The market conditions in respect of commodities subjected to such export duties have, from time to time, been changing and our exports have been experiencing price resistance and severe competition from alternative sources of supply in foreign markets. It is, therefore, quite necessary that the whole question of export duties is considered afresh in the light of these changed conditions in world markets. In the words of the Export Promotion Committee "to rely on exports as a stable source of revenue is most unsafe and is, indeed, opposed to every canon of fiscal prudence".

Broadly speaking, therefore, export duties should normally be avoided except in cases where such a levy is considered desirable so as to discourage exports for purposes of conserving supplies for home consumption and except where we have a position of monopoly as suppliers to the world. Even in the latter case, possibilities of substitutes and the efforts of other countries to provide alternative sources of supply will have to be taken into account. The levy of export duty with a view to making available to the Exchequer a part of the margin represented by the wide divergence between the internal price and world price may have some

justification, but the experience of the working of such levies in the country has been far from happy. It has led to steps in the direction of chopping and changing the level of export duties which have met with adverse reactions in the buying markets. Moreover, Executive action, when the difference in the price level had narrowed, has not been timely, and in the result the country has been faced with the risk of loss of markets built up as a result of a good deal of pioneering efforts.

Import Duties

Question 103.—Do you think that any changes are necessary in the Indian Customs Tariff in respect of—

- (i) grouping of commodities;
- (ii) additions to and alterations in tariff items;
- (iii) correlation with the Import Trade Control Schedule;
- (iv) clarification in nomenclature and in units of measurements or weight?

(i) The present classification is based upon the grouping of articles on the lines of affinity or attributes. The structure of the tariff schedule underwent a major revision in the year 1935. As the present grouping follows mainly the general procedure adopted for purposes of the Customs nomenclature drawn up by the Expert Committee appointed by the League of Nations, it may be claimed that the existing basis of arrangement has the support of the views of international experts in the matter. It is also relevant to mention that as the public who have to make use of the tariff schedules have become fairly familiar with the present arrangement, there is no justification, at present, for disturbing the same.

(ii) There are cases of entries which, in the light of the subsequent changes in the pattern of our imports, need no longer be in the same elaborate manner. Cotton piece-goods is a case in point. This is described under different sub-heads. Items of articles, the imports of which are no longer substantial, may, perhaps, be grouped under more consolidated heads.

In order to make the reference to the schedule easier and clearer, a machinery should be set up in the Department of Commercial Intelligence for examining suggestions, from time to time, for additional heads. In the same manner, proposals, oftentimes made for splitting the existing heads into different sub-heads according to quality, origin, etc., may also be considered. These are matters of detail which would require adjustment from time to time.

(iii) Customs Schedule should be correlated with the Import Trade Control Schedule. Government had appointed a Special Officer to go into this aspect of the matter and make recommendations designed to achieve the necessary element of correlation. The officer in question had discussed the matter with representative organisations and detailed suggestions were made in connection therewith. The object should be that an importer should be able to readily understand and know the corresponding classification in the Customs schedule in respect of the items covered by the serial number for which he has received import permission. Such an understanding of the position is necessary to have a clear idea of the duty payable on the items allowed to be imported as also to avoid disputes with the Customs authorities that the import permission did not relate to a particular item in the tariff schedule.

In this connection, suggestions have been made that both the import control and the customs, for purposes of tariff, should work on a common schedule. This is not considered feasible for the obvious reason that the purposes of the two schedules are entirely different; for example, in the import control schedule, in the same item, break up under a number of heads will be necessary as the import policy in respect of each such sub-head would have to be separately decided with reference to the demand position and internal availability. While, therefore, an arrangement which would facilitate cross reference between the two schedules would be helpful, correlation in the sense of making the two schedules either inter-dependent or common may not be feasible.

(iv) Complaints have often been received about the difficulties experienced in regard to the differences in view in regard to the nomenclature used in the classification. What is important here is that a machinery should be set up for purposes of clarification at each port centre in which public element should be associated. There are at present Customs Advisory Committees functioning in ports. Difficulties in regard to classification and nomenclature should be referred to such committees and, from time to time, an attempt made to clarify the position in respect of items which have given rise to differences or disputes. The results of such clarification should thereafter be published in a suitable manner.

Question 104.—(i) What considerations should govern the fixation of rates of import duties for different

groups or sub-groups of commodities or for special tariff items?

- (ii) Have you any modification to propose in the present rates of duties in the light of the considerations suggested by you?
- (iii) Do you consider that import duties should be reduced in respect of any specific commodities in order to reduce the scope for smuggling?
- (iv) Are there any cases within your knowledge where duties on the constituent parts are higher than on the finished product? Is there adequate justification, in your opinion for this differentiation?
- (v) Do you think that owing to high rates of duties the yield on any commodity has reached the point of diminishing returns?

(i) The general considerations that should weigh in the fixation of the rates of import duties for different articles or groups of articles were dealt with in detail in our preliminary observations. We would like to supplement the same by only one observation regarding duties intended primarily for protective purposes. In calculating the quantum of protection, the margin should not merely be equated to the difference between the cost of manufacture in the country and the landed price of the competing product. There should be an additional margin to cover the element of consumers preference to foreign goods as a result of long use.

(ii) Bearing in mind the general considerations referred to above, requests received from trade or industrial associations representing specific branches for reduction in the rate of duty on articles in their respective spheres may be considered. Particularly in the sphere of machinery and apparatus, there appears to be scope for greater concessional treatment in the matter of the rate of duty. Items of machinery are generally means of increasing production in the country. A reduction in the rates would be an encouragement to efforts for greater production, except of course in regard to such machinery as is being manufactured in the country.

(iii) It is common knowledge that certain items bearing duty at comparatively higher rates have encouraged smuggling in order to avoid the incidence of the duty. Silk and artsilk piece-goods, fountain pens, watches, diamonds, etc., are common instances. Even when imports of some of the items are precluded under the Import Trade Control, reports are current that they are being smuggled across the land frontier. So smuggling will have to be treated effectively.

Question 105.—Is the relative use of *ad valorem* and specific duties in the Indian Customs Tariff satisfactory? If not, in what respects would you enlarge or restrict the scope of application of either, whether used singly or in combination?

Ad valorem duties fall with equal weight irrespective of grades or quality on a particular commodity when imported under varying grades of quality. In the event of price fluctuation also the burden of the duty remains the same. The *ad valorem* basis is easy to understand and facilitates comparisons of the height of a particular levy. The chief drawback, however, is in the matter of assessment of value for purposes of estimating the levy. For obvious reasons, these values cannot be precise as they have to be determined by the Customs officials. Complaints about the arbitrary nature of the fixation of values by the Appraising officials are common. The fact that the value would depend upon the Appraising officials' decision affords chances for questionable practices being used in securing a favourable decision, requires consideration.

From the point of view of administrative convenience specific duties have an advantage, in that the amount of the duty would not be in dispute and would remain fixed. At the same time, the incidence under the specific duty would be higher on the lower grade of the same article or group of articles. Duty is recovered without any reference to quality or value of the article. In the light of the different objectives served by the Indian Customs Tariff, viz., revenue, protective and a combination of both, the use of both the methods, or a combination of both, is necessary and unavoidable. In the case, however, of specific duties, gradations by splitting up the same item under different qualities or strength or places of origin may be helpful in relating the burden to a greater extent to the price factor.

Question 106.—(i) In what circumstances would you consider "tariff values" a satisfactory basis for assessment of import duties? (Section 22 of the Sea Customs Act).

- (ii) Are there any commodities to which you would extend the application of "tariff values"?
- (iii) What changes, if any, should be made in the procedure for determining "tariff values"?

(i) Fixation of tariff values in effect means the introduction of the basis of specific duty for a given period of time, viz., one year. The arrangement of prescribing

tariff value at the commencement of the year is found to be very convenient particularly in respect of items which are subject to frequent price fluctuations. It eliminates chances of dispute both between the importer and the Customs on the one hand, and between the importer and his constituents on the other. In making contracts for sale of imported supplies, the importer is in a better position under a system of tariff values because he can estimate accurately the exact amount of the duty payable, in advance, and give his price quotations to his buyers on the basis thereof.

(ii) Every year, at the time of the annual revision of tariff values, suggestions are being made in regard to the introduction of additional tariff value heads. These suggestions are also being discussed with the departmental officers at frequent intervals.

(iii) Under the present procedure the tariff value for the ensuing year is based on the average of the market value prevailing for the item in question for the previous period of 12 months. The chief drawback in such an arrangement is that when the prices show a continuous downward tendency, the fixation of the value on the basis of the previous average amounts to recovery of duty at a higher rate. Therefore, in arriving at the tariff value the price trend should be a determining factor and due consideration should be given to the same in fixing up the value. Again, in respect of an item for which tariff value is fixed and for which the grades or qualities differ widely, the tariff value head should be split up into a number of sub-heads so as to make it possible to fix separate values for each such sub-head related to the prices prevailing for the items under such sub-head. Sometimes, the sub-division on the above basis will have to be by reference to the country of origin from which the article is imported. Such an arrangement is in vogue, but it should be more extensively applied.

Question 107.—(i) What changes in your opinion are necessary in the present provision (section 30 of the Sea Customs Act) regarding the determination of 'real value' and why?

(ii) Would you suggest any specific measures to counter the evasion of import duties through deliberate under-valuation?

(iii) Have the methods of valuation in the Sea Customs Act proved satisfactory in relation to trade through the land customs border, especially on the Indo-Pakistan border? If not, have you any specific suggestions to make in this regard?

The General Agreement on Trade and Tariff, vide Article VII, has defined the basis of valuation that should be followed for customs purposes. The European Customs Union Study Group of Brussels has drawn up a definition of value for the purpose of the levy of duties. The definition in question is somewhat similar to the "real value" as defined under Section 30 of the Sea Customs Act. The International Chamber of Commerce has drawn attention to the defects and drawbacks in the international definition in their brochure on International Trade and Government Regulations. Whatever be the form of ultimate definition decided upon, it is of importance that in the actual process of administration and interpretation of the definition, the importing interests should not feel that they are being harassed. Unless there is reason to doubt the *bona fides* of a particular case, the value as quoted in the invoice should normally be accepted. We are not over-looking the possibility of collusive arrangements between the exporter at the other end and the importer here. But such exceptional cases which *prima facie* give rise to doubts can be more closely looked into.

Question 108.—What changes would you suggest in the matter of granting exemptions from, or reductions in, import duties especially in regard to:

- (1) raw materials used for essential industries;
- (2) materials used for scientific research;
- (3) materials imported for charitable and humanitarian purposes;
- (4) materials imported for stimulating desirable activities, such as agricultural development; and
- (5) necessities of life?

(1) Government have the necessary power to grant exemptions or reductions in import duty on raw materials used for essential industries. These powers should be used very liberally. Perhaps, a general procedure may be introduced under which applications for concessional treatment in this respect are scrutinised by the Tariff Commission departmentally, the recommendations of the Tariff Commission being, as a matter of course, acted upon.

(2) Government have, earlier this year, by a press-note announced their intention to grant such exemption. It would, however, appear that the concession is intended for research in institutes sponsored by

Government or semi-Government bodies. It is relevant to point out that there are private institutions run for the purpose of promoting research. There are also research units attached to private industries. The concession should be equally available in such cases also.

(3) The grant of duty-free concession for materials imported for charitable and humanitarian purposes should be considered on merits of each case. Medical needs in case of epidemics of widespread diseases should, as a matter of course, be assisted by duty-free imports.

(5) We have already dealt with in our preliminary observations the general basis governing the levy of duty on necessities of life.

Question 109.—To what extent do you think revenue might be sacrificed in the interests of bilateral or multilateral fiscal arrangements such as GATT or the preferences in favour of certain Commonwealth countries?

It is difficult to estimate the effect on revenue or the balance of advantage resulting to the country as a result of the concessional arrangement, under the bilateral or multilateral agreements, in force. The Fiscal Commission went into the matter, but refrained from giving an estimate of the ultimate financial effect. So far as the Commonwealth preferences are concerned, the general feeling is that the arrangement has outlived its utility. The position will have to be considered *de novo*. In the matter of the GATT, as the Indian representatives have taken a direct part in negotiating these concessions, the desirability or otherwise of continuing the same should not be determined merely by reference to the balance of financial effect. In the context of the place and position of India as an active participant in international arrangements, such agreements need not be objected to so long as the concessions do not relate to products in respect of which a claim for protection is likely to be made by the country in the immediate future and do not result in excessive loss of revenue. Under the GATT India has received many direct or indirect concessions on some of its items of export. It has also granted concessions on a number of imports. The Fiscal Commission (1950) formulated certain basic ideas for the purpose of tariff negotiations. Firstly, in regard to tariff concessions to be received from other countries, India should concentrate on commodities which meet with competition from similar commodities from other countries in the world market and on commodities which meet with competition from possible substitutes from other countries in the world market and on manufactured goods rather than on raw materials. In the matter of granting tariff concessions, India should concentrate on capital goods, other machinery and equipment and essential raw materials. Our future agreements, both bilateral and multilateral, should be governed by the above criteria.

Question 110.—Under what circumstances should customs duties be used in preference to import quotas as a means of restricting imports?

Where the restriction in the volume of imports is necessary from the point of view of stimulating the growth or development of an industry in the country, the same should be achieved more by the levy of customs duties at adequate levels than by import quotas, unless of course to meet the requirements in a particular case a combination of both is considered desirable. Similarly, where the restriction of import is with a view to reduce consumption of certain articles or groups of articles, the results should be achieved by the levy of customs duties at appropriate levels. On occasions, however, when regulation of imports is necessary with a view mainly to conserve foreign exchange resources, quantitative controls would be preferable, for such imports as are necessary in the items controlled would not be penalised by a high level of duty. There would obviously be cases in which, although for larger reasons of policy the volume of imports have to be restricted, yet some quantity to the extent of meeting the essential needs will have to be allowed. In such cases, if the restriction is attempted by a high level of duty, the quantum required to be imported for essential purposes will bear an avoidable burden.

Question 111.—In what respects should the present law regarding "drawbacks" and "warehousing" be altered in order to assist the export trade in manufactured goods which involve the use of imported raw materials?

The Bill, at present before the Parliament, seeking to amend the Sea Customs Act would empower Government to allow drawback in respect of import duty paid on materials subsequently re-exported either in the same form or after processing. The main point to be emphasized is that drawback to the full extent of the duty actually paid should be available on such re-exportation and the formalities prescribed for the purpose of claiming such drawback should be simple. In addition, the question of the introduction of free zones,

where materials required for processing could be imported without payment of duty on the basis that the processed goods would be re-exported, has been under discussion for some time. The proposal did not evoke much public support because the same was considered with reference to only one port. The feasibility of a proposal under which free zones could be created at each port centre, where duty-free imports may be allowed, facilitating processing activities, may be examined.

Question 112.—Have you any suggestion to make regarding the administration of the Sea and Land Customs Acts, especially in regard to—

- (a) facilities for settlement of disputes arising out of appraisement; and
- (b) penalties imposed under the Act and the appellate procedure relating to them?

(a) Disputes arising out of appraisement are at present heard and decided by the officials of the Customs, viz., the Assistant Collector and the Collector. The possibility of some machinery in the shape of a Board for hearing such disputes at each port centre may be examined. Against the decision of the Collector of Customs, there is an appeal provided to the Central Board of Revenue. If a party feels aggrieved against the decision of the Central Board of Revenue, there is no appeal to a judicial authority except on matters of law. An appeal against the decisions of the Central Board of Revenue to an appropriate judicial authority may be provided.

Export Duties

Question 113.—Under what circumstances, in your opinion should export duties be imposed?

The general considerations which should weigh in the matter of levy of export duties have been dealt with in detail in our preliminary observations.

Question 114.—What measures would you suggest to achieve greater flexibility in the rates of duties to accord with the changing conditions of export markets?

Government have recently been empowered with powers to vary the duties to meet the situation arising out of price fluctuations in the export markets. Decisions regarding reduction or removal of export duties should be taken expeditiously and in time. The past experience has been that oftentimes the decisions taken are too late to achieve the purpose in view, with the consequence that the country is faced with the risk of permanent loss of markets as a result of encroachments made by competitors during the intervening period. In order to ensure that action in the direction of variation in the rates of duties is taken in time, we suggest the creation of a separate machinery with which non-officials should be associated for the purpose. Perhaps, the requirement could be met by empowering Port Export Advisory Committees to make recommendations for being placed before the appropriate Department of the Ministry regarding changes necessary in the rates of duty from the point of view of the effect of the prevailing rates on our overseas trade. Such recommendations should be immediately considered and wherever necessary acted on by Government.

Question 115.—Would you suggest that the whole or a part of the receipts from certain export duties should be funded for financing schemes for promoting long-range development of the export trade, subject to the obligations under GATT?

In the context of the emergence of increased competition, a purposive programme of assistance for stimulating exports is indicated. Among other things, a portion of the proceeds of the export duties may be earmarked for financing market research and for promoting schemes for development of export trade. The proportion thus reserved for expenditure on developing exports should be adequate to permit of export subsidies also being considered on occasions when such assistance is necessary for securing entry for our export products in a new market and for enabling them to withstand periods of abnormal competition.

Question 116.—Would you, in the interests of revenue or from any other point of view, recommend increased participation by the State in import and export trade? If so, what form do you think should such participation take?

We are strongly opposed to the State participating, directly or indirectly, in import and export trade. Our objections are two-fold: In the first place, we are not in favour of State Trading in any form, as in our opinion, State Trading is the very negation of the basic idea of freedom and equality of opportunity, which is the sheet-anchor of private enterprise. Secondly, from practical considerations, the State organisation is not at all suited for undertaking the responsibilities of and obligations involved in trading activities, more so in

the sphere of overseas trade. A State organisation built or set up for trade purposes cannot but be subject to political interference, which would impair the efficiency of any trading activity. Moreover, lack of personal interest and the fear of public criticism will always prove to be stumbling blocks against those in charge of a trade unit sponsored by the State taking quick and correct decisions. An officer in charge of a State undertaking would have to explain everything in a political way. The head of a private organisation can take quick decisions on his own responsibility. Risk taking and risk bearing are natural elements in the organisation and conduct of business under modern conditions, and with the emergence of keen competition they are all the more important in spheres connected with overseas trade. A State-sponsored organisation would be very reluctant to undertake these normal trade risks. Excessive reliance on safety-first principles would make a State undertaking grossly lacking in that energising element, which would strive to secure improvements in marketing methods that alone will enable the country to have increased and expanding markets for its manufactures. In the field of international trade, the sellers' market has almost ceased to exist. There is the general emergence of the buyer being able to dictate terms. Competition naturally would become keener, and the days when buyers would knock at the doors of the sellers and ask for their requirements are gone. By a process of exploration, by the search for new pastures, by a desire to meet the demands and tastes of the foreign consumers and by a studied and systematic effort to get a hold on the limited markets, for which there would be a great scramble, because of efforts and schemes for self-sufficiency everywhere, the country would have to nurse and nurture its overseas trade, particularly in finding export markets in the years to come. We venture to submit that for work of the above character, involving as it does a high degree of personal adaptability, a State organisation uninfluenced by the profit or personal success motive would be entirely ill-suited. It must also not be ignored that loss of a State undertaking would result in a national loss. An individual trading on his own account would naturally make every effort to cut down losses, as continuous losses to him would mean his personal ruin.

CENTRAL EXCISES

Excise as a source of revenue, was, in the earlier periods, used only during periods of financial stress. Otherwise, the levy was mainly intended for the purpose of introducing a regressive effect on the consumption of certain items like Drink or Tobacco. The general objection to the use of excise as a commodity taxation is that it singles out particular items or groups of items for special taxation which do not fall generally on other sectors. Where, however, the levy does not result in untaxed competition from outside sources or from substitutes within, the levy within reasonable rates and on a selected list of commodities, as a revenue earner, cannot be seriously objected to. The chief problem for decision however, is the selection of the items for purposes of the levy. The choice would be between imposing a tax on a large number of goods with relatively low rates, or confining it to a selective list in which the volume of turnover is large and the demand fairly inelastic. Even then, if the item is an essential of life, public sentiment, notwithstanding the tax incidence being comparatively low, would express itself against such a levy. The Fiscal Commission of 1921-22 laid down certain criteria in regard to the circumstances under which the levy of excise would be justified. According to the Commission (i) Excise duties should be ordinarily confined to industries which are concentrated in large factories or small areas; (ii) they may properly be imposed for the purpose of checking the consumption of injurious articles and especially on luxuries coming under this category; (iii) otherwise, they should be imposed for revenue purposes only; (iv) while permissible on commodities of general consumption they should not press too heavily on the poorer classes, and (v) when an industry requires protection and a consumption tax is also required from the produce of that industry in the interest of the revenue, the necessary amount of excise is unobjectionable, provided that it is accompanied by an import duty equal to the excise duty, together with the necessary protective duty plus a small extra duty to compensate for the administrative inconveniences to the manufacturer caused by the excise duty. In order to secure a greater coverage through indirect taxation so as to reach those sections of the community who do not contribute their share through direct taxation, the use of excise duty, as a tax source, can be justified if the articles selected for the purpose of the levy are of general consumption and the rate or rates of the levy are not such as to produce a regressive effect on consumption. Most of the commodities of general consumption in India are of the nature of necessities of life rather than luxuries and, therefore, particular care has to be taken in fixing the rate for the purpose of the levy.

Question 117.—Do you regard as satisfactory the present selection of commodities for purposes of levying excise duties? If not, what changes would you suggest and why?

In the sphere of Central Excise, excise duties are levied on kerosene, matches and mechanical lighters, motor spirit, salt, silver, steel ingots, sugar, tobacco, tyres, vegetable products, cloth, coffee and tea. There are also special excise duties on coal and coke, copra, oil crushed in mills and rubber. In addition, the States are entitled to levy excise duty on alcoholic liquors, narcotic drugs and spirituous medicinal and toilet preparations. In the light of the tests of suitability suggested by the Fiscal Commission, perhaps, the selection of articles for the purpose of excise duty cannot be objected to barring one or two items, but the same cannot be said about the rates at which the duties are levied particularly in respect of certain items. The levy of excise duty on steel which is an essential raw material for a number of industries is an instance in point.

Question 118.—(i) Have you any changes to suggest in the present rates of excise duties?

(ii) Are the provisions regarding valuation satisfactory where ad valorem excise duties are levied?

The high rates of excise duty on cloth are already proving to have a deterrent effect on consumption. In the same manner, the rates in force for motor spirit and tobacco have been the subject of frequent complaints. In the case of motor spirit the existence of a countervailing import duty might be considered as an extenuating factor. So far as tobacco is concerned, the grievance is more on account of the rate having been made steeper by successive changes within a short period of years.

We have not had serious complaints in regard to the basis of valuation where excise duties are levied on ad valorem basis.

Question 119.—Do you think that the differential rates of duty on different types of unmanufactured tobacco, other than flue-cured, should be replaced by a uniform rate of duty? Have you any other suggestions regarding the tobacco excise tariff?

The tobacco interests have expressed themselves strongly against the existing basis of differential rates of duty depending upon the capability of the tobacco being used for more than one purpose. The chief drawback of that basis is that there is room for a good deal of administrative arbitrariness and the consequent harassment of the trader. On the other hand, the introduction of a uniform rate of duty—at a rate sufficient to yield the expected revenue,—would, besides eliminating the difficulties complained of in the process of administration, encourage the use of better quality tobacco. In particular, the trade strongly feels that after payment of a uniform rate of duty at the unmanufactured stage, there should not be any further formality in connection with the taxation of this item.

Question 120.—Do you think that the lower rate of duty on the cottage match industry has been helpful to its development? If not, would you suggest any change in the existing rates of duties?

A lower rate of duty on matches produced on a cottage industry basis does not appear to have been helpful in assisting the cottage industry to consolidate its position. Other forms of assistance will have to be considered for the purpose of strengthening this industry.

Question 121.—Do you think that the arrangements for the assessment and collection of excises in respect of manufactured and unmanufactured commodities require simplification? In particular, please comment on the present system as regards

(a) licensing,

(b) warehousing, and

(c) transport

of excisable commodities.

The sugar interests particularly have often complained about the practical hardships resulting from the existing arrangements regulating warehousing and transport in the enforcement of the requirements in regard to excise. The detailed aspects of these hardships, we understand, are being placed before the Commission by the interests concerned.

Question 122.—Do you agree that a part of the proceeds of excise duties may be earmarked for expenditure on research and development schemes designed to improve the quality and marketability of the commodities?

The excise duty is mainly levied for the purpose of revenue and the proceeds should normally go towards strengthening the overall budgetary position. It is not proper to earmark the proceeds of excise duties for expenditure on research and development unless the benefit from such efforts accrues exclusively to the

advantage of the industry or the commodity paying the excise. In particular, the levy of an excise duty on one industry for strengthening or assisting another industry is open to objection, the more so when the products of the assisted industry are competing directly or indirectly with the products of the industry paying the levy.

Question 123.—Do you think that the imposition of excise duties has affected adversely the development of industries producing excisable commodities, e.g., their size and competitive capacity in export markets?

The levy of excise duty will affect the competitive capacity of industries in export markets. But the provision for grant of rebate in respect of excisable goods exported somewhat mitigates the position. However, the procedure and formalities connected with the grant of rebate should be simplified and arrangements should be made whereby the rebate is obtainable as a matter of routine and almost immediately after the exports have taken place.

SALT DUTY

Question 124.—Would you recommend the re-imposition of the excise duty on salt? If so, on what conditions?

From the point of view of taxation principles and objectives, the salt tax is a form of taxation which would readily commend itself. In the first place, salt is a commodity in everyday use by the common man. On that basis, a levy, even at a small rate, would, in aggregate, fetch a substantial revenue. It cannot be said that the abolition of the salt tax has led to an improvement in the purchasing power of the people who have been relieved of the burden of this levy. The Taxation Enquiry Committee had estimated the burden per head per month at nine pies on the basis of the average consumption of half-a-seer per month at the then existing level of duty. At the same time, it must be realised that the issue is not free from certain sentimental aspects. It is, in this connection, relevant to point out that the abolition of the Salt Duty has not resulted in the increased availability of cheap salt of good quality all over the country. The feeling is justified that in the present context of the need for additional source of revenue, the incidence of which will be spread widely, the Salt Tax may not meet with any serious opposition.

GENERAL OBSERVATIONS ON SALES TAX

Importance of Sales Tax in the Taxation Structure of the States in India :

Sales tax as an important source of revenue has been comparatively of a recent origin in India. It was first introduced in India prior to the war in two Provinces, namely, Madras and Bombay, with the object of making good the loss in revenue as a result of the adoption of the policy of prohibition. Whereas, however, in Madras the sales tax was of a general application, in Bombay, when it was introduced, it had only a limited application, the tax being levied and collected only on certain specified articles. During and after the war, the remaining Provinces, one after the other, resorted to this impost with the object of finding additional revenue required by them among other things, for financing their reconstruction and development programmes. By now, sales tax is in force in almost all the States in the Indian Union, including some of the Part "C" States. In some of the States like Bombay and Madras, it has been the largest single source of revenue. The former derived therefrom a revenue of Rs. 10.61 crores in 1952-53, which worked out to approximately 29.11 per cent. of its total tax revenue. As far as the sales tax proceeds of all the Part "A" States are concerned, the same amount to Rs. 43.87 crores which works out to 18.73 per cent. of their total tax revenues of Rs. 234 crores. As regards Part "B" States, the yield from sales tax amounted to Rs. 7.10 crores representing 10.51 per cent. of the total tax revenue of these States of Rs. 67.54 crores.

Disparities in the Sales Tax Legislations of the different States :

The development of sales tax as a major source of revenue in the taxation structure of the States has, however, not taken a scientific and rational basis. This explains the lack of uniformity in the sales tax policies and administration followed in the different States. The sales tax policies of the different States were largely governed by the sole consideration of revenue. Each State tried to exploit this new elastic form of taxation for collecting as much revenue as possible. In their anxiety to make full use of this impost, they were oblivious to the effects of their sales tax policies on the economy of the country as a whole. The effects have been on the whole very deleterious on trade, commerce and industry of the country. The existence of numerous rates, the adoption of different bases by different States for the levy and collection of tax, the divergent

policies followed in regard to the application of tax on particular commodities or groups of commodities, the imposition of sales tax on the same transaction by more than one Sales Tax Authority, the procedure and formalities laid down for the levy and collection of the tax and other disparities in the sales tax legislations have affected the economy of the country very adversely. The incidence of sales tax being quite substantial, the potentialities of this tax being a great handicap in the regional distribution of the country's trade and industry on a planned and scientific basis cannot be ignored altogether.

Difference in basis of the levy :

The disparities in the sales tax policies followed by the various States are many. In the first place, the very basis of the collection and recovery of the sales tax is different from State to State. Whereas in certain States, the tax is collected on the basis of single point, in certain other States, the same is collected on the multi-point basis. Again, in certain States mixed bases are found. For instance, in the State of Bombay, under the Sales Tax Act as it exists at present, although broadly speaking the system is mainly multi-point, in regard to certain articles two-point system has been adopted, under which the tax is collected at the first and last stage in the series of transactions.

Dissimilarities in Rates :

Dissimilarities in rates are also conspicuously observed in the sales tax legislations of the various States. The rates generally vary from 6 pies in the rupee in certain States like Bengal, Assam and Delhi to 3 pies in the rupee in other States like Bombay, Uttar Pradesh, Madras, Orissa and Travancore-Cochin. Further, two sets of rates are levied in some of the States. States like Bombay, Madras, Madhya Pradesh, Assam levy two sets of rates side by side, viz., ordinary rate applicable to the sale of all goods and the special rate applicable to what are called 'luxury goods'. Again, whereas in East Punjab the rates are left to be fixed by Government, in Bihar, the same are laid down from year to year by the Annual Finance Act. In Madhya Bharat the Act only lays down the maximum and minimum rates, leaving it to the Executive Authority to fix the annual rates from time to time.

Disparity in turnover limit :

Another point of disparity is in respect of fixation of turnover limits for the liability to tax and registration for the purpose. In some of the States two turnover limits are fixed for the various kinds of dealers, a lower limit being fixed in the case of manufacturers, processors and importers and a higher limit in the case of dealers other than manufacturers and processors; in other States the same turnover limit applies to all kinds of dealers. The turnover fixed for importers and manufacturers and processors is generally Rs. 10,000, although in a few States it is Rs. 5,000. The turnover in the case of other dealers varies between Rs. 5,000 and Rs. 30,000.

Divergence in policy in regard to exemptions :

Divergence in policies is also noticeable in respect of exemptions from the sales tax levy. Whereas in certain States industrial raw materials like cotton, coal, iron and steel are taxed, they are exempt in other States. Again, while supplies made to Government Departments and Public Utility Undertakings are free of tax in some States they are liable to tax in other States.

Need for Uniformity :

The disparities in the sales tax policies followed by different States as above and the harmful effects of the same on the economy of the country as a whole emphasize the need for steps being taken to bring about as large a measure of uniformity in the sales tax policies as possible. As a matter of fact, the question of uniformity in sales tax policies has been engaging the attention of the Government of India for the last more than five or six years. This question was discussed at several important Conferences such as for instance the Finance Ministers' Conference held under the auspices of the Central Government. Various suggestions and proposals made at the Conference were discussed and considered but so far these discussions have not brought about any tangible results in the direction of uniformity in the sales tax policies. One main reason for this state of affairs is the reluctance on the part of some of the States to surrender their right of making such changes and modifications in the sales tax policies as would be necessary for getting the revenue required by those States from this flexible measure of tax.

It is significant to note here that a suggestion was made at the Industries Conference, which was held in the year 1947, that the Central Government should collect the tax on a uniform basis and distribute the proceeds therefrom to the States on some agreed formula. Under the Constitution, sales tax is a sub-

ject coming within the competence of the States and it is, therefore, only the States who can legislate in respect of this levy. The centralisation of the tax would, therefore, necessitate the amendment of the Constitution. It is, however, a moot point whether in view of the anxiety of the States to retain this source of revenue within their exclusive jurisdiction, the States would be agreeable to the suggestion of amending the Constitution so as to enable the Centre to legislate for the levy of tax on the sale or purchase of goods in the various States. Looking at the question from the practical stand-point, therefore, it may be suggested that sales tax may be allowed to be continued as a State levy but that an attempt should be made to bring about a maximum degree of uniformity in regard to the major aspects of the sales tax policies followed by the different States. In this, a large amount of responsibility rests on the Union Government and it is upto them to take the necessary initiative in the matter. There are certain aspects of sales tax on which uniformity is greatly desirable from the point of view of maintaining the economic cohesion of the country and avoiding the harmful effects of the divergent policies followed by the various States.

As a matter of fact, with the advent of the new Constitution, uniformity was expected in respect of two important aspects of sales tax, viz., list of exemptions and the transactions in the course of inter-State trade and commerce. In actual practice, however, these expectations have not been realised.

Exemptions :

Clause (3) of Article 286 of the Constitution lays down that "no law made by the Legislature of a State imposing or authorising the imposition of a tax on the sale or purchase of any goods as have been declared by Parliament to be essential for the life of the community should have effect unless it has been reserved for the consent of the President and has received his assent". Although the necessary legislation under this provision of the Constitution has been passed by the Central Government, the much desired uniformity in regard to exemptions has not been achieved. It is so because the Central Legislation, viz., the Essential Goods (Declaration and Regulation of Tax on Sales or Purchase) Act contains a provision whereby the prohibition provided in the Act on the powers of the State Governments to levy sales tax on the essential articles does not apply in the case of levies which were already existing prior to the passing of the Act. It will thus be seen that the States which were levying sales tax on the 'essential articles' immediately before the passing of the Act have been allowed to continue those levies in spite of the fact that the goods in question are of an essential nature. This provision has seriously detracted from the value of the above central measure as a useful instrument for bringing about uniformity in regard to an important aspect of sales tax.

Inter-State Transactions :

As regards inter State transactions, it was expected that with the coming into force of the new Constitution, the perplexities and confusion created by the divergent policies followed by the various State Governments in regard to the levy of tax on transactions of an inter-State character would come to an end. In actual practice, however, the confusion has been worse confounded. The provisions of the first two clauses of Article 286 of the Constitution are as under:

"286 (1) No law of a State shall impose, or authorise the imposition of a tax on the sale or purchase of goods where such sale or purchase takes place (a) outside the State: or (b) in the course of the import of the goods into, or export of the goods out of, the territory of India.

Explanation.—For the purpose of sub-clause (a), a sale or purchase shall be deemed to have taken place in the State in which the goods have actually been delivered as a direct result of such sale or purchase for the purpose of consumption in that State, notwithstanding the fact that under the general law relating to sale of goods the property in the goods has by reason of such sale or purchase passed in another State.

(2) Except in so far as Parliament may by law otherwise provide, no law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of any goods where such sale or purchase takes place in the course of inter-State trade or commerce:

Provided that President may by order direct that any tax on the sale or purchase of goods which was being lawfully levied by the Government of any State immediately before the commencement of this constitution shall, notwithstanding that the imposition of such tax is contrary to the provisions of this clause, continue to be levied until the thirty-first day of March 1951."

The Article seeks to restrict the powers of the State Governments to levy tax on the sale or purchase of

goods where such sale or purchase takes place outside the State concerned or in the course of import of the goods into or their export outside the country. The Article also seeks to prohibit the State Governments from levying purchase or sales tax on transactions in the course of Inter-State trade and commerce. The provisions in question are, however, so clumsily worded that they have lent themselves to varying interpretations with the result that different State Governments interpreted them in such a manner that the levy of sales tax on inter-State transactions has continued in some form or other. This led to unnecessary controversy and litigation causing inconvenience and hardship to the merchants and traders who are engaged in such transactions.

The legal position of inter-State transactions *vis-a-vis* the Constitution has now been finally decided by the Supreme Court in their judgment in the Bombay Sales Tax Case. The Supreme Court has decided that Article 286(1) (a) read with Explanation thereunder prohibits tax on sales or purchases involving inter-State elements by all States except the State in which the goods are delivered for purposes of consumption therein. In other words, as regards inter-State transactions, the Supreme Court is of the opinion that it is only the State in which goods are actually delivered for the purpose of consumption therein is competent to levy sales tax on such transactions to the exclusion of all other States. Thus, for instance, if a merchant in Bengal delivers goods to a merchant in Bombay for the purpose of consumption in Bombay, as a direct result of the sale, the Government of Bombay is only competent to levy sales tax on these transactions. Although this Supreme Court decision has clarified the position of sales tax in regard to inter-State transactions, it has created a number of difficulties of a practical nature. Following the judgment of the Supreme Court, various State Governments have served Notices on the dealers in other States supplying goods to the parties in their own State calling upon them to produce their books of account relating to their sales to the parties in their own States and to pay the tax under their own sales tax legislations on the same. This has caused great deal of hardship and inconvenience to the mercantile community. In the first place, if the sales tax law of one State is made applicable to the dealers residing in other States, it would mean that the latter will have to be thoroughly conversant with the sales tax laws of all the States to which they are supplying goods and keep themselves informed of the changes that are made thereunder from time to time in order to ascertain their exact liability under the sales tax legislations of the States concerned. As a matter of fact the commercial community is finding it difficult to observe the formalities laid down under the Sales Tax Act of the State in which their places of business are located. If they are simultaneously brought with the purview of a number of sales tax laws, it would greatly add to their hardship and inconvenience.

Secondly, the other implication of the applicability of the sales tax legislation of one State to outside dealers would mean that they will have to submit their account books before the Sales Tax Authorities of not only various States but of different areas in all those States. Again, the dealers will have to keep and maintain their accounts in a manner required by the sales tax laws of the various States. This will particularly inflict a great hardship on the dealers.

Sales Tax on Exports :

As will be seen from the provisions of Article 286 quoted above, the Constitution seeks to restrict the powers of the State Governments in regard to the levy and collection of sales tax on the sale or purchase of goods, where such sale or purchase takes place in the course of import of the goods into or export out of India. The exact implications of these provisions were the subject-matter of a judgment given sometime back by the Supreme Court, in the appeal preferred by the United State of Travancore & Cochin from the judgment given by the Travancore-Cochin High Court in what are called "Cashew-nut Cases". The Supreme Court came to the conclusion that the implications of the provisions in question are as follows:

- (1) Sales by export and purchases by import fall within the exemption provided for under Article 286 (1) (b) of the Constitution.
- (2) Purchases in the State by the exporter for the purpose of export as well as sales in the State by the importer after the goods have crossed the Customs Frontier are not within the exemption.
- (3) Sales in the State by the exporter or the importer by transfer of shipping documents

while the goods are beyond the Customs Frontier are within the exemption assuming that the States' power of taxation extends to such transactions.

It will thus be seen that in terms of the judgment of the Supreme Court sales by a manufacturer or supplier of goods to an exporter for the purpose of exports outside the country prior to such export does not fall within the exemption provided for in Article 286 of the Constitution.

Directions of Reform :

The need and importance of attempts at uniformity in sales tax policies has been pointed out above. The steps in respect of which such uniformity is desirable and the steps to achieve the same may now be indicated. Firstly, the basis of tax should be uniform. From all considerations, it would appear that single-point basis is the most suitable form of sales tax that can be adopted by the States.

Comparison of the effects of the two main systems of levy :

There are two main systems of sales tax, *viz.*, the single-point and the multi-point. The multi-point basis of sales tax is an inequitable form of taxation and its cumulative incidence on trade and industry is very heavy. Under the multi-point system of sales tax, the tax is levied at each and every stage through which the commodity changes hands. This, therefore, adds to the cost of the supplies of raw materials, components and other articles required for manufacturing and processing purposes, thus raising the cost of production of the finished article. In the result, multi-point system of sales tax weakens the competitive capacity of the finished products of one State as against the products of the other State where the single-point system is in vogue. Under the single-point system, tax is generally levied and collected at the retail stage, *i.e.*, when the goods are sold either to unregistered dealers or to the consumers directly, the earlier sales, *i.e.*, sales between one registered dealer and another registered dealer being free of sales tax. Sales of goods by registered dealers to the manufacturers and processors would, therefore, naturally be exempt from the sales tax levy. The manufacturers and processors who are registered under the Act are, therefore, in a position to make their purchases of raw materials and other goods required for their manufacturing and processing activities without any sales tax. As regards the manufacturers who are not registered under the Act by virtue of their turnover being less than that laid down for the purpose of tax liability and registration, sales by registered dealers to such manufacturers will attract the tax, the transaction being one between a registered dealer and another unregistered dealer. Sales of the finished products by such unregistered manufacturers will, however, not attract the sales tax as the Sales Tax Act does not bring within its purview unregistered dealers. On the whole the manufacturing cost of the various products does not, therefore, rise directly on account of the sales tax under the single-point system. From the point of view of manufacturing costs, therefore, the single-point system is decidedly preferable to the multi-point basis.

Disparity in incidence of tax under the two systems :

The incidence of sales tax on various articles under the single-point system is the same, whereas it varies under the multi-point system, according to the nature of the article. On an average, an article is supposed to change hands three or four times. There are, however, certain articles which change hands even a larger number of times. Such articles will, therefore, bear larger tax burden under the multi-point system.

Effect on Organisational arrangements of Trade :

The multi-point system disturbs the organisational arrangements connected with the handling of trade. Goods pass through various traditional channels or agencies handling trade in successive stages, such as the manufacturer, the importer, wholesaler, semi-wholesaler, sometimes an agent, the retailer and the shop-keeper or the vendor. In the anxiety to reduce the price-spurt consequent on the frequency of changes through the above traditional channels, there is a tendency for reduction in the number of stages which inevitably leads to the displacement of trade channels. This was one of the main reasons for the strong opposition of the commercial community of this State to the introduction of the multi-point system of sales tax in the State by the Government of Bombay last year. The apprehensions entertained by the mercantile community on this score seem to have been borne out by

facts. There are complaints from various sections about the tendency on the part of the manufacturers or the importers to eliminate the traditional intermediary channels and reach the consumer directly, in order to avoid the incidence of sales tax that would be required to be paid if the goods were allowed to pass through the traditional channels.

Effect on Exports :

Under the single-point system, just as there is an automatic exemption of goods and materials required by manufacturers in their manufacturing and processing activities, there is a similar automatic exemption under that system for goods purchased for the purpose of exports outside the State limits. No such automatic exemption, however, obtains under the multi-point system. On the contrary, it being the principle of multi-point sales tax that tax would be attracted at each stage in the series of transactions, the cost of the articles which are bought for the purpose of exports outside the State limits goes on increasing with every addition in the number of links. In the context of the export drive which our country has launched with a view to retaining the markets which have been captured during some time past and to capture new export markets if possible, it is very essential to see that the competitive capacity of our export products is not affected adversely in any way. Further, it is a patent fact that there has been recently a shift in the world markets and these markets have now changed from sellers' to buyers' markets with the result that our export products have to meet with increasing consumer's resistance in the foreign markets. It is, therefore, of the utmost importance that the tax burden on our exports is kept at the minimum level possible. From this point of view also, it would appear that multi-point sales tax is not a desirable form of sales tax.

Effect on Trade :

It has been pointed out above already that multi-point sales tax leads to the elimination of the intermediary traders. The manufacturers and the processors as also the consumers, instead of making their purchases from the dealers within the State try to procure their requirements of supplies and other goods directly from other States where single-point sales tax is in existence, with a view to avoid the consequence of tax that would be payable if the goods are purchased from the internal sources. This inevitably leads to the diversion of the trade from the dealers in the State where the multi-point system exists to the dealers in other States.

Concealment of tax liability under the multi-point system :

Under the single-point system, the buyer or the consumer knows the exact extent of the tax burden. Under the multi-point system, he would have no direct and exact knowledge of the incidence, as he has no method of checking up the previous tax borne by the article purchased by him. He might feel that the price quoted to him minus the tax is the price of the goods and on that account might feel that the price charged to him is unduly high.

Administration and enforcement of the Act :

Under the single-point system of sales tax, manufacturers and wholesalers who generally carry on transactions only with registered dealers have not pay any sales tax, sales between one registered dealer and another registered dealer being tax-free. Secondly, although such manufacturers and dealers are required to be registered under the Act by virtue of their turnover being above the limit prescribed for the purpose of registration, they can get a general exemption from the requirement of having to make returns of their turnover. The manufacturers and dealers are, therefore, spared a great deal of formalities to be observed under the sales tax law. Under the multi-point system of sales tax, however, sales tax being charged on every stage of transaction, even manufacturers and wholesale dealers having transactions with registered dealers only have also to pay sales tax and they have to observe all the formalities in connection with the payment of tax and the filing of periodical returns. The work of the Sales Tax Department also is greatly minimised under the single-point tax, owing to the fact that the number of assesseees under the single-point system is smaller than under the multi-point system. The multi-point system, therefore, would require a larger number of staff than under the single-point, thereby increasing the administrative expenditure.

From the above discussion about the merits and drawbacks of the two systems of sales tax, viz., the single-point and the multi-point sales tax, it will be seen that the former is preferable to the latter in many respects. It would, therefore, be appropriate to suggest that all the States should levy and recover sales tax on the basis of single-point levy.

Secondly, there should be, at least, some uniformity in regard to the rates levied in the various States. As

has been already pointed out above, the varying rates result in unequal distribution of the burden of sales tax on the trade and commerce of the various parts of the country and leads to diversion of trade and industry from areas which have higher tax burden to the areas with less burden. In order to obviate this tendency, it will be necessary to see that the disparities in the rates of taxation are not wide. It will be reasonable to suggest that one way of reducing the tax burden on the industry and bringing about uniformity in regard to rates will be to place a ceiling on the maximum rates that can be levied by the States.

Thirdly, there should be a uniform list of articles to be exempted from the sales tax levy. As has been pointed out above, The Essential Goods (Declaration & Regulation of Tax on the Sale and Purchase) Act passed by the Union Government under the provisions of Article 286(3) of the Constitution permits the continuance of the levy of sales tax on the 'essential goods' by the States which were having such levies prior to the commencement and enforcement of the Act. This provision is acting as a serious handicap in the way of attainment of uniformity in regard to an important aspect of sales tax and it is imperative to take early measures to modify the provisions of the Act, so as to preclude all States from levying sales tax on goods which are declared as 'essential' and enumerated in the Schedule appended to the Act. The Essential Goods Act only lays down certain articles which are essential for the life of the community. There are also other articles which require to be exempted from the levy of sales tax on other considerations. The main industrial raw materials, for instance, like iron, steel, cotton, cement, coal, oilseeds and oils, etc., should be included in the Schedule of exemptions. The exemption of such main industrial raw materials is most essential from the point of view of minimising the tax burden on the industries and enabling them to reduce the cost of production of the finished articles. Another principle that should be borne in mind in regard to the drawing up of the Schedule of exemptions is that all such goods as are subject to other taxes should be free from the levy of the tax by the States. Articles like tobacco, matches, vanaspati products, etc., which are subject to the central excise duty should be outside the purview of the sales tax levied by the States, since the imposition of the sales tax on these articles would mean subjecting these articles to double taxation and result in increased burden on the consumer.

Fourthly, no sales tax should be imposed by any State on goods going outside the State limits, both to the destinations in the Indian Union and to the overseas destinations. The sales tax legislations of all the States, therefore, should contain a provision laying down that sales tax should not be levied on any goods going outside the State limits. The provision should be clearly worded and there should be no scope for doubt about its implications. Further, it is necessary to point out that goods going outside the country should not bear tax at any point, as otherwise, the competitive capacity of our exports is weakened *vis-à-vis* similar products coming from other sources in the foreign markets. The provisions of the Constitution in question which, as already stated, have led to a great deal of confusion and difficulties of a practical nature should be suitably amended at an early date. The problem created by the interpretation by the Supreme Court of the provisions of the Article in relation to inter-State transactions particularly requires to be solved as expeditiously as possible, as in the wake of that judgment, various State Governments have issued notices on outside dealers asking them to produce account books before their Sales Tax Authorities and to pay sales tax on the goods supplied by them to the parties in their own States, and this is causing serious inconvenience and hardship to the dealers.

Finally, it is necessary to emphasize the need for making the Sales Tax Law very simple so as to make it easily intelligible to all those who are affected by it. As the obligations in respect of sales tax have to be discharged by a large number of merchants and traders who normally do not have elaborate organisational facilities, it is necessary to stress the importance of making the tax structure and the formalities prescribed thereunder so as not to cause difficulties of a practical nature in its actual implementation. The sales tax legislations of some of the States are of a very complicated nature. The present Bombay Sales Tax Act, for instance, and the formalities prescribed thereunder have been found to be irksome in actual working and the dealers are not in a position to find their exact liability with ease under the provisions of the Act. The scheme and structure of sales tax embodied in the Bill recently introduced by the Government of Bombay in the State Legislature and referred to the Select Committee is still more complicated than the scheme and structure contained in the present Act. The Bill envisages as many as six levies such as Sales Tax, General Sales Tax, Purchase Tax, Outside Goods Purchase Tax, Special Goods Sales Tax and Special Goods Purchase Tax. The Bill, broadly speaking, seeks

mainly to provide for the imposition of sales tax at two points. The provisions prescribed for the purpose of ensuring the two-point levy are further of an intricate nature and will create hardships and difficulties in actual working. The point that must be noted, in this connection, is that as Sales Tax Law is of a general application and brings within its purview a large number of smaller dealers who do not have the organisational set-up to understand their exact obligation and liability under the law, it should be as simple as possible. The levies prescribed under the law should be very few and the procedure and formalities laid down in connection with the assessment and payment of the tax should also be simple so as not to cause any undue inconvenience and hardship to the dealers who are affected thereby.

With these general observations, we would proceed to answer the questions in the Questionnaire bearing upon sales tax.

Question 125.—*Under the Constitution, the only sales or purchases which can be taxed are sales or purchases of goods. Do you consider that the sales tax should be extended to—*

- (i) services, so that the tax may be leviable on (a) charges for services proper (e.g., bills from a goldsmith or a printer), (b) charges for both services and goods where the two cannot be readily separated (e.g., hotel bills) and (c) charges for certain types of goods, into the price of which service enters as a substantial element (e.g., paintings or photographs); and
- (ii) transactions of sale or purchase in stock exchanges and futures markets? If so, please deal with the administrative and other issues which may arise in the implementation of your suggestions.

We favour the continuance of the present position under which sales or purchase tax could be levied only on transactions involving transfer of goods as such. It is not desirable to extend the same to the services. The income from services wherever they are of a taxable character or quantum bears taxes in the shape of income-tax. Rendering services of the kind under reference, even where the services are compensated by payment, cannot be construed as in the nature of transactions involving transfer of goods. We are also not in favour of levying sales tax in respect of transactions involving sale or purchase in stock exchanges and other forward markets. Transactions in such markets, over and above the taxes borne directly or indirectly, are subject to levy of stamp duty, the incidence of which has shown progressive increases in recent years. No additional impost in the shape of sales tax on such transactions would be justified.

Question 127.—*As regards sales tax generally and, in particular, the sales tax on goods leviable by the States, it is sometimes argued that—since all goods sold in a State must fall within one of three categories, viz., (a) manufactured or produced within the State, (b) transported into the State from elsewhere in the country, and (c) imported into the State from abroad—an extension or increase of excise would serve just as well as sales tax for category (a), of octroi or terminal tax for category (b), and of customs for category (c). Do you agree with this view which implies that the sales tax has no specific function to perform in the country's system of taxation? If not, what in your opinion, from the point of view of correlated tax-structure, is the legitimate place and scope of the sales tax as distinguished from that of excise, octroi and customs?*

The sales tax is essentially a tax on consumption and it is a levy which normally can be passed on to the consumer, who is expected to bear the incidence of the same. If the tax burden consequent upon such a levy is to continue as a normal feature of our tax structure, we would prefer that the same should be continued in its present form as sales tax as a separate levy instead of any proposal to aggregate it by an extension or increase of levy such as excise, octroi or customs.

Question 128.—*(a) Sales tax is almost invariably levied by the State Governments in terms of the turnover of the dealer over a given period. Since a sales tax leviable on the individual transaction necessitates fairly elaborate accounts, cash memos, etc., which only a small proportion of dealers is equipped to maintain, do you agree with the view that, in Indian conditions, the bulk of the sales tax is likely, for a long time to come, to continue to be leviable on aggregate turnover as distinguished from the individual sale-price?*

If liability to sales tax is to be determined by the extent of the aggregate turnover of an individual dealer without going into the details of the transactions which have resulted in the turnover, provided the rate of tax is kept very low and not subjected to variations from

practical considerations same would appear to be very advantageous. But at the same time, we cannot be certain that such an arrangement would eliminate the requirement in regard to preservation of accounts, cash memos, etc., for the obvious reason that the turnover figures will have to be established before the assessing authorities and in the process of verification, the authorities would require production of such evidences as would establish the correctness of the turnover figures estimated or given by the assessee.

Question 128.—*(b) In most States there are separate laws governing sales tax on petrol. To what articles, if any, do you consider it desirable and feasible to extend the particular system adopted in respect of petrol?*

We are not in favour of petrol being treated separately under a distinct law. We have suggested elsewhere that the State tax on petrol should be merged with the fuel tax levied by the Centre and a part of the proceeds from the composite levy should be distributed to the States on the basis of a formula linked to consumption of petrol in each individual State.

Question 129.—*(1) In regard to a system of levy based on turnover, is the choice broadly limited to the alternatives hereinafter mentioned or is there any other system you would advocate? Under the system you recommend would sales tax continue to be roughly as significant a source of State revenue as at present? The alternatives referred to above are:*

- (i) a relatively low rate of levy at each of almost all points of sale; few dealers excluded and few goods exempted (multi-point);
- (ii) a relatively high rate of levy at only one point, viz., the point at which a registered dealer sells either to a consumer or to an unregistered dealer; exemption from tax of sales by one registered dealer to another registered dealer; exclusion from compulsory registration of a dealer below a certain limit of turnover; a large number of exempted goods (single-point);
- (iii) Various combinations of the above.

We have dealt with the issues covered by the question in detail in our preliminary observations. We would only supplement the same by giving our categorical view that so long as sales tax as an item of major taxation is continued it should be on the basis of single-point levy. We are also opposed to any proposal involving a combination of more than one basis of levy.

While on this, we would also urge for the consideration of the Commission the desirability of substituting a system of purchase tax in place of the present sales tax. Purchase tax also ensures tax being levied only at one point, viz., at the last point where the goods pass on to the consumer. Such a proposal should be examined only if all the States are in favour of introducing the same basis in their respective tax systems, eliminating altogether the sales tax. One great advantage would be that the system of purchase tax would eliminate the elaborate requirements in regard to maintenance and preservation of accounts in the form in which they are required to be maintained at present. In many of the advanced countries of the world, particularly in the West, generally purchase tax is in vogue, there being no sales tax as such.

Question 129.—*(2) Which of the above alternatives would you advocate? Please state your reasons in some detail, comparing merits and demerits from the point of view of (a) the consumer, (b) the dealer, (c) industry, trade, etc., generally, and (d) Government. Please relate your arguments, as far as possible, to lessons which may be drawn from the actual working of Sales Tax Acts in different States.*

(3) In particular:

- (i) As regards (a) above, do you think that the sales tax, or any particular form of it, leads to a greater burden being placed on the consumer than is accounted for by the proceeds which accrue to the Exchequer?
- (ii) as regards (b) above, have you any suggestions to make regarding the simplification of forms, accounts, etc., and of the procedure generally in order to make the administration of the tax less burdensome to the dealer? Further, having regard to the cost of maintenance of the machinery for compliance, would you suggest an alternative form of taxation so far as small dealers are concerned?
- (iii) as regards (c) above, has the imposition of the sales tax led to any noticeable change in the organisation of the trade in the country, especially in regard to the size of the business

unit, location of head-offices, number of intermediaries, variety of the goods dealt with, etc.?

- (iv) as regards (d) above, please examine the financial and administrative aspects, including the scope for evasion presented by the particular system and the difficulty or otherwise of counteracting it.

The issues covered by this part of the question have been dealt with in detail in our general observations. Our supplementary suggestions are that as the sales tax law generally affects a large number of small businessmen, who have not the necessary organisational set-up to understand the intricate provisions and requirements under the law and to discharge the obligations in the direction of maintaining elaborate accounts, which necessitate guidance by experts, it is very essential that the structure of the law and the detailed provisions thereunder should be made very simple and easily understandable. The administrative formalities should also be considerably minimised. In the case of dealers whose turnover generally does not exceed Rs. one lakh, the production of their normal account books to support their turnover figure should be deemed sufficient. Elaborate forms and return should be avoided in the case of such small dealers. Again, the assessments should be completed almost immediately. The present practice of merchants being required to maintain and preserve records for periods stretching over two and three years is found to be very onerous. Some of the consequences resulting from the levy of sales tax in the State has been discussed in our preliminary remarks. The displacement of the normal trade channels and diversion of trade from the traditional centres are major consequences noticeable. We would earnestly urge that whatever recommendations are made in regard to the structure and scheme of levy of sales tax, the Commission would lay due emphasis on—

- (i) the need for uniformity both in regard to the basis and in regard to the other essential details connected with the structure,
- (ii) the importance of the scheme being simple and easily understandable by the ordinary trader, who is affected by it in a day-to-day manner,
- (iii) the levy being such as would be easy in the process of collection,
- (iv) the importance of seeing that the incidence of the tax is not strikingly noticeable, and
- (v) that the tax is at the stage of the ultimate consumer, for sales tax is essentially on consumption.

The arrangements and the basis of the levy should not be such in any area as to result in the diversion of traditional trade from that area to another.

Question 130.—In relation to the particular system you advocate :

- (i) should there be special rates of levy, higher than the ordinary rate, for certain articles? If so, for which types of articles?

Broadly speaking, we are not in favour of a system under which there would be graded or differential rates for different groups of articles. Except in regard to articles which require to be completely exempted from the levy by reason of their essential character, the basis and rate of levy should be uniform. If for meeting the budgetary exigencies of a particular State it is found necessary to levy the tax at a higher rate on certain articles, then the list of articles subjected to the special levy should be confined to items which are really of a luxury nature. At present in Bombay, in terms of the new Bill, the special levy is to be inflicted on as many as 54 items, some of them of a day-to-day essential character, such as aerated water, sweetmeats, bicycles, stainless steel domestic utensils, fountain-pens, etc. The Central Government have declared that certain articles should be considered as essential and free from liability to sales tax. In the same manner, if tax at a higher rate is deemed inevitable on certain items, the list of articles subjected to such a higher levy should be standardised by the Central Government and the same list should apply uniformly to all the States. Otherwise, the present practice of the higher rate of special tax leading to artificial arrangements for diversion of trade, e.g., the Bombay user buying his motor car from upcountry dealer will continue.

Question 130.—(ii) Should there be special rates of levy lower than the ordinary rate, for certain articles? If so, for which types of articles?

Normally we are not in favour of more than one rate of levy, provided the general rate is reasonable; but if the general rate is kept comparatively higher, then relief by way of reduced rate should be given in respect of items in common use entering into the daily budget of the poorer sections of society. It is not difficult to frame a list of such items meriting special treatment, once the policy underlying the same is agreed to.

Question 130.—(iii) Which articles, if any, should be exempted altogether and why? Please elaborate the principles, which, in your opinion, should underlie exemptions.

The list of articles to be exempted should be uniform for all the States. First and foremost, goods declared as essential under the central legislation should, as a matter of course, be exempted without the present position of prior levies continuing. The main and basic raw materials used by industries should, as a matter of course, get exemption. There is also strong support for the point of view that articles which are subject to special levy by other taxation enactments, such as excise, special cess, etc., should be free from the levy of sales tax.

Question 131.—In regard to system, rates, exemptions, etc., what degree of uniformity between the different States do you consider desirable and feasible? Would you bring it about—

- (i) by formal or informal convention;
- (ii) by central legislation promoted at the instance of two or more States;
- (iii) by constitutional amendment, so as to include certain basic matters connected with the sales tax in the Concurrent List?
- (iv) by constitutional amendment so as to include the item of sales tax, as a whole, in the Union List? In the last-mentioned case, how would you apportion the proceeds? Would this alternative be a practicable proposition from the point of view of the finances of the States?

We have already dealt with this issue in great detail in our preliminary observations. Uniformity is essential and should be achieved, whatever the methods adopted. In the light of the experience of the working of the sales tax in the different States and the attitude of insularity shown by some of the State Authorities, there is considerable force in the point of view that sales tax should, by a constitutional amendment, be made a subject under the direct control of the Union Government. It is not difficult to evolve a formula governing distribution. As in the case of the divisible pool of the Income-tax, the division could be on a pre-determined basis and as sales tax is a tax on consumption, it could be very readily suggested and agreed that the division should be linked to consumption. But from practical considerations, it is perhaps difficult to expect the State Governments to agree to surrender their right in respect of sales tax or agree even voluntarily to transfer the same from the State List to the Union List. In the event of such transfer not being considered feasible, the other alternative should be for certain essential matters like the basis of levy and collection, the items to be exempted and sales tax on inter-State trade and commerce to be brought under central jurisdiction. Failing agreement on efforts in the above direction, at all events, by informal measures, the Central Government should take the initiative in creating conditions favourable for the acceptance of an informal convention, under which on the above basic and general aspects, uniformity would be secured.

Question 132.—To what extent has any desirable uniformity been achieved in regard to exemptions (in favour of "goods essential for the life of the community") under Clause (3) of Article 286 of the Constitution? What principles would you advocate for deciding the exemptions to be made under this provision of the Constitution? Do you consider that the scope of the provision contained in Clause (3) of Article 286 should be extended also to "essential articles" which had been subject to sales tax before the relevant central enactment came into force?

Unfortunately, the spirit underlying the provision in Article 286(3) regarding exemption of goods "essential for the life of the community" has not been properly observed in certain States by reason of the existence of a prior levy or some of the items declared as "essential" by the central legislation. We have already commented on this aspect in greater detail earlier. Essential articles which had been subject to sales tax before the coming into force of the central enactment should also get the benefit of the exemption.

Question 133.—(a) As regards "sales outside the State", "inter-State commerce", etc., please discuss the adequacy or otherwise of the relevant provisions of Article 286 and suggest remedies for any defects which, in your opinion, have been revealed in the actual working of these provisions.

We are of the considered opinion that no sales tax should be imposed by any State on goods going outside the State limit, both to destinations within the country and overseas. The immunity from liability should extend to all stages of transaction which ultimately result in the goods going outside the State limits. Illustrating the point, if, as a result of the organisational arrangements connected with any trade in a particular State,

in the process of export outside the State, such goods change hands more than once, successive stages of the transaction should all be free from liability, so long as the goods ultimately leave the limits of the State concerned.

Another point which we would like to emphasize is that dealers resident in a State should not be brought within the jurisdiction of Sales Tax Authorities in another State on the ground that the destination State would be the State competent to levy sales tax. The Supreme Court Judgment in that regard has led to difficulties of a practical character. A dealer in Bombay, for instance, having transactions with constituents spread over the different States, is expected to conform to the requirements of the State laws of all such State Governments, get himself registered under their respective laws and subject his accounts to be inspected by the authorities of the respective States. The confusion resulting from such a position can be easily imagined. There should be some territorial limitation to the application of the sales tax legislation and the legislation of a particular State should not apply to a dealer in another State unless the dealer in question is himself trading directly or through agents in the State concerned.

Question 133.—(b) Please discuss in this connection the desirability and feasibility of the suggestion that purchases only (and not sales) should be taxed, so that the tax jurisdiction of each State might be confined to parties residing within the State. Alternatively, do you consider that purchases should be taxed in certain cases and sales in certain others; if so, how and on what considerations would you define the two categories? In either case, please describe your scheme in some detail and explain the advantages which you claim for it.

We have already earlier suggested the desirability of purchase tax being introduced in place of the present scheme of taxation on sales. Such a change is being suggested only if all the States agree to the substitution. We are also not in favour of a combination, under which both purchase tax and sales tax would be enforced. By far the most important advantage under a scheme of purchase tax is that it would eliminate the complications that have been noticed in relation to inter-State trade, as the tax liability would be at the stage of purchase. It would incidentally also reduce administrative and procedural formalities under the sales tax scheme. Public reaction to these formalities has been quite unfavourable.

Question 134.—Do you think that lack of uniformity between the States as regards the rates of sales tax and the methods of applying it (single or multiple point) has the effect of raising barriers in inter-State commerce or of inducing uneconomic diversions of trade? If so, what measures would you suggest to rectify the position?

The defects and drawbacks resulting from the lack of uniformity between the sales tax structures in different States have been discussed at length in our preliminary observations. The absence of uniformity has been one of the main contributing factors for artificial arrangements resulting in diversion of trade from traditional centres and channels. The remedial measures are obvious. The system of taxation should be uniform, the rate structure should be uniform and the list of exemptions should also be uniform.

STATE EXCISES

Question 135.—(a) In regard to State excise duties and the revenue therefrom, have you any comments or suggestions to make—

(i) on features of importance connected with the system of levy of these duties in different States

or

(ii) on policies involving various degrees of relinquishment in certain States of the revenue from these duties?

Should there, in this context, be uniformity between different States? If so, in what particulars and to what extent?

So far as the State of Bombay is concerned, the revenue from excise has gone down substantially. In the peak year 1946-47, the revenue from this source of taxation was Rs. 9.74 crores. A decline, year by year, is strikingly noticeable. In 1947-48, it went down to Rs. 8.54 crores, in 1948-49 to Rs. 6.17 crores, in 1949-50 to 4.09 crores, in 1950-51 to Rs. 1.07 crores, in 1951-52 to Rs. 0.92 crores, in 1952-53 to Rs. 0.97 crores and in 1953-54 to Rs. 1.12 crores. The largest contributing factor for this set-back is the impact of the prohibition policy. The State of Bombay and certain other States have given top priority to the enforcement of prohibition. We are aware that in terms of our Constitution, State Governments are expected to endeavour to bring about prohibition of the consumption of intoxicating drinks. We also acknowledge the desirability of this

reform on social grounds. At the same time, in the light of the overall picture of public finances of the States, we feel that the time, pace and stages of the enforcement of prohibition should not be in such a manner as to cause serious disequilibrium in the budgetary position of the States. Economic considerations indicate the desirability of introducing an element of graduality in the present programme of enforcement of prohibition in the different States. There is also support for the point of view that the pace and stages of enforcement should be linked to the programme of all-India application. The larger objective underlying this reform will, perhaps, not be realised if certain parts of the country alone are either completely or in selected regions made free from the habit, without any progress having been made or any proposal for such progress being considered in other States in the country itself.

Question 135.—(b) Is there proper co-ordination between the levy of central excise on medicinal and toilet preparations containing alcohol, etc., and of State excise on alcoholic liquors? If not, what steps would you suggest to ensure adequate co-ordination?

Considerable difficulties are experienced as a result of lack of co-ordination in the levy of excise as between the Centre and the States on the one hand and as between the different States on the other. The difficulties in that sphere were the subject-matter of expert scrutiny and a Committee appointed by the Government of India had gone into the question of the rates of duty on spirituous medicinal preparations. Apart from the rate and the level of the duty, the difference in the pace of acceleration of prohibition policy in the different States has led to difference in arrangements for use of alcohol in medicinal and toilet preparations and conditions accompanying their use, handling and movement. This is a sphere in which co-ordinated action is necessary and the Central Government may be desired to initiate efforts which would result in the rates of duty and the conditions governing use of alcohol in medicinal and toilet preparations being made uniform.

GENERAL

Question 136.—Do you think there is a case for vesting in the administration the power to alter, by executive order, the rates of import duties, export duties and excise duties? If so, please indicate in what circumstances and within what limits such power should be exercised.

Normally, it would be undesirable to vest in the executive powers for varying rates of import, export and excise duties. These rates should preferably continue to be fixed by statute and any change in the same should only be on the basis of parliamentary sanction. The introduction of export duties at substantial rates during the period of war in our scheme of commodity taxation, however, necessitates some arrangement for flexibility to meet exigencies resulting from market changes in other countries. In the case of export duties, particularly where the duty acts as a disincentive for exports or is found to be coming in the way of increased exports, the executive authority should be in a position to bring about adjustments by immediate reductions wherever necessary. In the case of import duties, however, the executive should not have power to vary duties, which are of a protective character. Executive decisions involving variations in rates of duty should be placed for parliamentary approval at the earliest opportunity. In the case of excise duties, we do not envisage the necessity for provision empowering the executive to vary the same from time to time.

Question 137.—Do you visualise any scope for extension of the field of commodity taxation as a result of the implementation of the Five-Year Plan?

As a result of the Five-Year Plan, the commodities liable to taxation will increase in supply and the turnover of such commodities would also automatically increase. Their exports would result in larger yield of aggregate revenue from export duty. Apart from the augmentation of the overall revenue position, consequent upon increased supply and increased turnover, in the spheres of import duty and excise also, larger import activities necessitated by the development programme of the country would bring in larger revenue in the shape of customs duty; the feasibility of levy of excise duty at very low rates on some new articles may be examined. Increased production would yield increased excise revenue. Beyond, therefore, the additional revenue resulting from expansion of activity, we do not consider that there would be additional scope for extension of commodity taxation by new or increased levies.

Question 138.—What "luxury" articles, if any, would you suggest on which commodity taxes in any of the various forms might be levied at specially high rates?

The term 'luxury articles' is relative. What may be considered as luxury in certain circumstances would be essential, even normally, for certain requirements

We are, therefore, not in favour of introducing an element of higher rate based on such classification of commodities as luxury or essential. It must not be overlooked that the levy of tax at almost prohibitive

rates on items of luxury would result in a regressive effect on the use or consumption of such items and the higher incidence defeating the object in view, *viz.*, increased revenue.

PART IV.—AGRICULTURAL INCOME-TAX, LAND REVENUE AND IRRIGATION RATES.

Tax on land is the recognised and traditional form of taxation since the earliest times. In fact, in the old days when the taxes on income and commodities levied at present were not at all thought of, taxes on land and the Poll Tax were the only sources on which the State had to rely for its finances. Even as late as the 19th century land taxes contributed a major share of the total revenues of the countries. In recent years, however, with the introduction of taxes on personal incomes and commodities, land taxes hold a less important position and they contribute a small proportion of the total revenues of the countries. The following table indicates the extent of the decreasing importance of land revenue in the finances of India:—

Percentage of land revenue to the total revenue of India

Year	Percentage	Year	Percentage
1881	53.75	1924	20.75
1894	46.77	1939	15.50
1904	42.76	1949	4.05
1914	35.42	1950	4.36

Thus, while almost all other taxes have increased in recent years, land revenue which used to be the mainstay of Government, 50 years ago, contributing over 50 per cent. of the total revenue of whole of India, has in 1949-50 contributed less than 10 per cent. of the State revenue and 5 per cent. of the total revenue of India.

Tax on land at present comprises land revenue, tax on agricultural incomes and irrigation rates. While land revenue is the common and the prevalent method of levying taxes on land, agricultural income-tax is levied in the States of U.P., Bihar, West Bengal, Assam, Orissa and Travancore-Cochin. The rates of agricultural income-tax vary from State to State. The maximum rate at which the tax is levied is 4 annas in the first four States but 3 annas only in Orissa. In addition to the usual tax, a super-tax at the maximum rate of 5 annas 3 pies on incomes exceeding Rs. 25,000 per year is levied in U.P. The exemption limit is Rs. 3,000 in West Bengal, Assam & U.P., Rs. 3,500 in Bihar and Rs. 5,000 in Orissa. The whole of the agricultural income of companies is taxed at the maximum rate of 4 annas in the rupee in West Bengal and U.P. The Government of U.P. also levies a super-tax at the rate of 1 anna on the agricultural income of companies. In Bihar and Orissa, the companies are taxed on slab system on the same basis as individuals. In Assam, the agricultural income of companies has two slabs only, *viz.*, income below Rs. 10,000 is taxed at 2 annas and 6 pies in the rupee and income above 10,000 rupees at a rate of 4 annas.

The contribution of irrigation rates is insignificant at present, but with the completion of the various irrigation projects, this source of revenue offers a good scope for increased income for supplementing the general revenues of the States.

Taxes on land do not affect the commercial community directly. In the wider sphere of public finance, however, all taxes are interrelated and, therefore, to the extent that agricultural taxes affect the general revenues of the country, they have an indirect bearing on the commercial community. Thus, changes in the agricultural taxes do affect the general revenues of the country and its impact is bound to have repercussions on the taxation structure as a whole. This, in turn, would necessitate the changes in taxes on incomes and commodities with which the business and industrial community is directly concerned. Without going into the matter of relative details, therefore, we would like to confine here to certain aspects concerning overall policy of agricultural taxation.

As stated earlier, land revenue which is a common form of taxation on land, has lost its significance as a source of contributions to the State Exchequer. For a number of years, the revenue from this source has remained more or less static. Other taxes like income-tax, sales tax, customs duties, etc., have been increasingly resorted to whenever the Government is confronted with financial stringency. The scope for increased revenue from land requires to be scientifically investigated. Besides strengthening the finances of Government, it will also, to some extent, correct the main defect of the existing structure of taxation of our country, *viz.*, very narrow range of population made to bear a relatively heavy burden of taxation. In recommending this we are supported by no less an authority than the Planning Commission, whose observations on the point bear repetition.

"A striking feature of the present structure of taxation in India is the relatively narrow range of

population affected by it to any appreciable extent. About 28 per cent. of the total tax revenue comes from direct taxation which directly affects only about half of 1 per cent. of the working force in the country, estimated at 133 million in 1948-49. Another 17 per cent. is accounted for by import duties, a considerable part of which is derived from taxation of commodities like motor vehicles, motor spirit and oils, high quality tobacco, silk and silk manufactures, liquors and wines, etc., which effect but a relatively small section of the population. A large proportion of the excise duties on tobacco and cloth, which yield about 8 per cent. of the total tax revenue, is also probably paid by the limited number of consumers who use better varieties. Given the structure of incomes in the country, it is of course inevitable that the coverage of direct taxation should be narrow; it is also right that an element of progression should be introduced through higher taxes on commodities which, relatively to the general pattern of consumption of the community, may be regarded as luxuries. In fact, ways and means for raising the revenue from this source must be constantly explored. But if as much as one-third or more of the total tax revenue is derived from certain limited strata of society, it is implied that the burden of taxation spread over the rest of the community is correspondingly lighter and that relatively small increases in the rates of taxation on the latter will help to add significantly to total tax revenue."

Stating that it was a taxation on land which in Japan provided the initial resources required for development, the Planning Commission further observed that:

"In recent years prices have moved in favour of primary commodities and, since, in most parts of the country, land revenue has not been raised upwards, the burden of this tax has been considerably lightened. It is reflected partly in the fact that land revenue contributes at present only about 8 per cent. of the total tax revenue as compared to about 25 per cent. in 1939. The rise in agricultural prices has, however, benefited significantly only producers with sufficiently large marketable surpluses; it is also true that costs of production have gone up in many cases. The improvement in prices cannot therefore by itself be made the basis for a substantial upward revision of the tax on land. But within the context of a development programme designed as much to raise agricultural prosperity as to promote all-round economic development, a programme towards which all sections of the community have to contribute to the maximum extent possible, there is a case for moderate upward revision of land revenue. . . . Betterment levies designed to draw into the public exchequer, a proportion of the capital gains that accrue to private parties as a result of development are a recognised device for strengthening public savings."

The shift in prices, resulting in more benefits to the agricultural class than the industrial and commercial community has become more pronounced in recent months.

The case for an upward revision of land revenue is on strong ground. The Indian Taxation Enquiry Committee, as early as 1924, had pointed out that too light assessments are not in themselves very much conducive to agrarian progress. On the contrary, "the lightness itself has aggravated evils since it has had the result of converting many a land-holder who would have had to cultivate his land if the State share had been larger, with the rent-receiver living on the proceeds of another's labour".

We are, therefore, of the considered opinion that a general increase in the rates of land revenue is both justified and necessary in the context of the present search for additional sources of revenue. Again, those settlements which are already due for revision should be reassessed and increased yield from land revenue as a result of an upward revision of the assessments should be secured. It would be reasonable to provide that a part of the increased value of land as a result of the implementation of the irrigation schemes should accrue to the benefit of the State which is incurring the expenditure in financing the schemes. This could be done by the levy of betterment tax, irrigation cess or water cess. Possibilities of imposing surcharges on irrigation rates based on crop values for the purpose of financing projects of a local character may also be considered. On the question of agricultural income-tax, while in the past

informed opinion was in favour of removing the anomaly and making agricultural income subject to direct taxation, we are inclined to feel that in the context of the far-reaching reforms on land tenure now undertaken by the different State Governments resulting in the elimination of large holdings, perhaps, the question of the levy of agricultural income-tax is of less significance. In any scheme of taxation of agricultural income, the exemption limit has to be higher. The land tenure reform policy would preclude chances of indefinite continuance of large holdings and consequently large incomes from agricultural sources to individual owners will also come to be eliminated. In that view of the case, we feel that the case for levy of direct taxation on agricultural income has not the same significance and importance in the altered conditions envisaged, and we are, therefore, inclined to the view that such increased revenue required to be secured from land should be on the basis of increase in the rate of land revenue.

PART V.—FINANCES OF THE STATE OF BOMBAY.

Before dealing with the question relating to other State Taxes in Part V of the questionnaire, we would like to make some general observations on the overall

financial position of the State of Bombay so as to emphasize the aspects concerning increase of expenditure in the State, the consequent increase in the level of taxation and steps necessary to bring about an improvement in the overall financial condition of the State. For a period of 15 years beginning from 1921/22 to 1936 the Government of Bombay had a budgeted expenditure closely adjusted to a budgeted revenue, the successive years ending with either a nominal surplus or a deficit which was not of a big magnitude. From 1935/36 the finances of the State indicated signs of recovery. It was in that year that Government passed the Motor Vehicles Act, 1935, which yielded substantial additional revenue. The period immediately following saw quick changes in the taxation policy of the State. In the year 1938/39 a number of new or additional taxes were levied such as increased electricity duty, increased Court Fees, sales tax on tobacco, enhancement of tobacco licence fees and increased tax on betting. In the year 1939/40 Government decided upon the introduction of Prohibition. In order to make up the loss in revenue on this account, a number of new imposts were decided upon, the chief among them being the Urban Immovable Property Tax and Sales Tax on petrol. Then came the war years. The general financial position of the State of Bombay during war years is indicated by the following table:

General financial position of the Government of Bombay—1940/41 to 1945/46

(In lakhs of Rupees)

Year	Revenue	Expenditure charged to revenue	Nominal surplus or deficit	Net transfer to S. D. F.	Transfer to P. W. R. Fund	Transfer to D. R. & A. Fund	Actual surplus or deficit
1940—41	14,48	13,61	+ 87	84			+ 1,71
1941—42	16,86	15,26	+1,61	87			+ 2,48
1942—43	19,70	17,78	+1,91	— 16	1,40		+ 3,15
1943—44	25,20	21,50	+3,70	1,11	1,11		+ 5,92
1944—45	33,66	30,61	+3,03	1,90	4,50	2,00	+11,45
1945—46	34,96	34,12	+ 84	—1,31	5,50	2,00	+ 7,50

The period witnessed rapid increase both in revenue and expenditure. Substantial amounts were transferred to the Special Development Fund and the Post-war Reconstruction Fund and the Debts Redemption and

Avoidance Fund. During the period of the war Government accumulated a total revenue surplus of more than Rs. 32 crores. The sub-joined table indicates the position for the period thereafter:

General financial position of the Government of Bombay since the year 1946/47

(In lakhs of Rupees)

Year	Revenue	Expenditure charged to revenue	Nominal surplus or deficit	Net transfer to S. D. F.	Transfer to P. W. R. Fund	Transfer to D. R. & A. Fund	Actual surplus or deficit
1946—47	40,17	36,41	+3,76	1,55	2,30		+7,51
1947—48	43,75	41,33	+2,40	— 4	4,16		+6,52
1948—49	49,91	47,06	+2,85	— 12	1,70		+1,03
1949—50	61,53	61,52	+ 1				
1950—51	64,31	64,37	— 5				
1951—52	62,70	62,58	+ 12				
1952—53	64,34	64,34	—3,90				
1953—54	67,84	67,76	+ 8				

Since 1938/39 the total revenue has risen by Rs. 55,40 lakhs, an increase of about 450 per cent. Apart from the phenomenal rise in the size of the provincial revenue, striking changes have also taken place in the composition of the same. Thus, while land revenue and excise were the most important items of revenue in 1938/39 contributing about 29 per cent. and 23 per cent. respectively of the total revenue, in 1953/54 the Sales Tax and the State's share of taxes on income other than Corporation Tax figure prominently, contributing about 29 per cent. and 19 per cent. respectively of the total earnings of the State during the year.

In fact, Sales Tax, Urban Immovable Property Tax, Prize Competition Tax and Newspaper Advertisement Tax were not at all being levied in the year 1938/39 while these taxes have proved to be lucrative sources of revenue to the State Government in recent years. Receipts on account of the excise duty have considerably

fallen on account of the adoption of the policy of total prohibition. The extent of loss of revenue as a consequence of the policy of prohibition would be clear from the fact that while the excise duty receipts rose from Rs. 290 lakhs in 1938/39 to Rs. 974 lakhs in 1946/47 which was the peak year, they dwindled to Rs. 112 lakhs only in the year 1953/54. Apart from this loss of Rs. 862 lakhs in 1953/54 over the year 1946/47, the expenditure incurred for the enforcement of the policy added a further heavy charge on revenue of the State. To compensate this loss, therefore, the State Government was compelled to resort to the fresh taxation like Sales Tax, Urban Immovable Property Tax, Prize Competition Tax, etc., and to increase the rates of existing taxes such as Motor Vehicles Tax, Entertainment Tax, Electricity Duty, etc.

The following table gives a comparative idea of the main sources of the revenue of the State as in the year

1938/39 and in 1953/54 and the extent of the increase or the decrease, both in respect of the individual heads and in regard to the overall position :—

(In lakhs of Rupees)

Item of revenue	Total income in 1938-39	Total income in 1953-54 (Budget)	Increase	Per cent Increase (+) Decrease (—)
1. Taxes on income other than Corporation Tax	30	10,32	10,02	+3340
2. Land Revenue . .	3,55	6,67	3,12	+ 87
3. State Excise . .	2,90	1,12	—1,78	— 67
4. Stamp Duty . .	44	4,20	3,76	+ 855
5. Forests . .	41	3,21	2,80	+ 683
6. Registration . .	14	31	17	+ 121
7. Motor Vehicles Tax .	45	2,15	1,70	+378
8. Entertainment Tax .	24	2,70	2,46	+1025
9. Tobacco Duty . .	22	..	..	..
10. Electricity Duty . .	18	2,00	1,82	+1011
11. Urban Immovable Property Tax	..	1,51	1,51	..
12. Prize Competition Tax	..	13	13	..
13. Sugarcane Cess . .	64	42	—22	— 34
14. Newspaper Advertisement Tax	..	..	..	..
15. Sales Tax . .	..	16,00	16,00	..
Total (including other revenues)	12,44	67,84	55,40	+ 445

During the 15 years since 1938/39 land revenue is the only source which has recorded the least increase and has remained more or less static. Receipts under land revenue rose from Rs. 355 lakhs in 1938/39 to Rs. 559 lakhs in 1949/50 and to Rs. 667 lakhs in 1953/54. The rise in the year 1949/50 over the year 1938/39 was mainly accounted for by the additional receipts from the merged areas. Some of the settlements are already due for revision and a proposal for a surcharge on land revenue was actually made in the budget last year. In this context, the observation of the Planning Commission that the tax base is very narrow and requires widening for increasing the tax revenues, is particularly significant. Of the total income of Rs. 924.43 crores of the State of Bombay in the year 1950/51, Rs. 392.59 crores or 42.47 per cent, are earnings of agriculture, animal husbandry, forestry, fisheries, mining and salt. A substantial part of the expenditure under the Five-Year Plan is also proposed to be spent on development of agriculture, irrigation and power, and rural development. In assessing the result of the Plan, the Planning Commission estimates that the largest addition to national output is expected to come from the agricultural section. Land revenue, on the other hand, contributes only 10 per cent. of the total revenue of the State at present as against 29 per cent. in the year 1938/39. In view of this, there is a strong case for increase in land revenue at least, leaving alone for the time being the ultimate decision on the question of the levy by the State of Income-tax on agricultural income.

A review of the budgetary position of the State since the year 1939/40 indicates certain trends which call for an entire review of the pattern of public expenditure in the State and the tax structure which is sustaining that expenditure. In the year 1938/39 the total revenue and expenditure of the State was just over Rs. 12 crores. Both revenue and expenditure have gone up to over Rs. 67 crores in 1953/54. After a series of surplus years from 1940/41 the State Government have been confronted with the position of having to make up small deficits from the year 1949/50. As the deficit position year after year is showing a progressive worsening, the State authorities found themselves obliged to resort to the expedient of adding fresh taxes or stepping up or increasing the rates or revising the basis of existing taxes from time to time. Bombay already is the most heavily taxed State in the country. The citizens of the State cannot bear the present level of taxation indefinitely, let alone any increases thereto, which in effect, means that the State cannot sustain the present level of expen-

diture. Viewed from that standpoint, the main problem before a State like Bombay is one of efforts to restore budgetary equilibrium by concentrating on step necessary to reduce expenditure.

The expenditure of the State on development activities, including social services, has been of the highest order. While in a welfare State expenditure on development activities will have, it must be agreed, to continuously expend, there are limits to the extent to which the present generation can be expected to tighten up their belts in the interests of future prosperity. The ideas therefore, of the rate of annual expansion in such development expenditure and the extent to which such expenditure, essentially of a capital nature, should be found from the revenue resources, will have to be revised and adjusted to the actual realities of the financial situation confronting the State. It is, therefore, desirable to emphasize the need for greater degree of graduality in the pace and programme of implementation of the steps designed to achieve the objective of welfare State. Further, the practice of charging expenditure of capital nature to revenue account is highly objectionable in principle as well as on practical grounds. In the year 1951/52 the Government of Bombay charged to revenue account an expenditure of Rs. 105 lakhs on major irrigation schemes, and in 1952/53 charged Rs. 100 lakhs, which was an expenditure of capital nature, to revenue account.

Economy in the administrative expenditure is another way of strengthening the financial position of the State. While readily agreeing that Government had actually carried out, from time to time, measures designed to curtail avoidable expenditure, it cannot be denied that administrative expenditure forms a substantial part of the total expenditure of the State.

We have entered into a detailed discussion of the budgetary position of the State of Bombay with a view to emphasize the importance of a detailed examination of the question as to whether the present level of annual expenditure in the State of Bombay can be sustained without harmful and permanent effects on the economy of the State and the people, and if the expenditure in its present magnitude is essential and unavoidable, to what extent the same could be met by alternatives to increased taxation, viz., by steps such as introducing a greater degree of graduality in the pace of developmental programme, and by retrenchment in civil expenditure to the extent that such retrenchment is feasible particularly in the spheres of fresh or additional activities undertaken by the State during the period of the emergency.

OTHER TAXES (CENTRAL & STATE)

Stamp Duties and Court Fees :

Question 162.—Under the Constitution—

- (1) the Union is empowered to fix the rates of stamp duties in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts, and
- (2) the States are empowered to fix the rates of all other stamp duties.

As regards both (1) and (2), have you any suggestions to make for the levy of a stamp duty where it is not already levied, or for an increase or decrease of the present rates where a stamp duty already exists? Please give reasons for your suggestions. Are there any general principles which you would propose for adoption in regard to the fixation of rates of stamp duties?

As regards (2), since the rates vary from State to State, what degree of uniformity do you consider desirable and feasible, and how do you propose to achieve it?

If possible, please estimate the net effect of your proposals on the revenues of States.

The constitutional position governing the right to the levy of Stamp Duty is leading to anomalous results. In terms of entry 91 in List I, viz., Union List, in Schedule VII of the Constitution Act, the rates of Stamp Duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts will be regulated by Central legislation, whereas rates of duty in respect of documents other than those enumerated above will be regulated by State legislations. Thus, while in the case of the former list of documents, the legislating authority being common, uniformity in the rates of duty all over the country is ensured, in the case of the latter widely varying rates are in force.

The basic rates of Stamp Duty were first prescribed by the Indian Stamp Act. After the year 1921, in respect of the items which came within the State jurisdiction, there have been a series of State (Provincial) Acts designed to increase the rates of duty for the instruments within the State sphere. The enhanced duty varies from State to State, and instruments executed and stamped in one State, when received in another State where the stamp duty is higher, is

required to be charged with the excess. This is another handicap, which requires to be avoided. Uniformity in rates will remove the necessity of documents stamped in one State being required to be surcharged in terms of the stamp fee requirements in another State.

Apart from the enhanced rates of stamp duty, some of the States have also passed what are called Surcharge Acts, increasing the duties leviable under the Indian Stamp Act as amended and in force in the particular State, by way of a surcharge. In the State of Bombay, the surcharge is at the rate of 50 per cent. of the duty payable; Orissa and U. P. levy a surcharge at the rate of 25 per cent. while in Bihar the surcharge is at 37½ per cent. Thus, in effect the rates levied in the various States are much higher than the rates prescribed in the Schedule to the main Act, viz., the Indian Stamp Act. For example, on a conveyance, where the value of the consideration is Rs. 1,500, the duty payable, according to Art. 23 of the Indian Stamp Act, is only Rs. 15. But as a result of the surcharges imposed by the various States, the duties actually leviable are as follows:

Bombay City	Ra. 58	plus 50% surcharge
Ahmedabad and Poona City	43	50% "
Madras	28/8	25% "
M. P. and Bihar	30	
U. P.	28/2	25% "
W. Punjab	28/2	

It is evident from the above that the duty payable in the different States has been increased in a substantial manner, the incidence being the highest in Bombay State, viz., nearly 6 times the rate originally prescribed by the Schedule to the Stamp Act. Incidentally, it may be pointed out that, whereas the revenue from Stamp Duties, judicial and non-judicial, in the State of Bombay in the year 1939-40 was Rs. 1.38 crores, it went up to Rs. 4.18 crores in the year 1950-51.

In view of the highly varying nature of the incidence of the duty as between State and State, it is essential to secure some uniformity in the levy of Stamp Duty. The suggestion that the Centre alone should be empowered to fix the rates of Stamp Duty in respect of all kinds of documents is on strong grounds, in view of the experience of the working of the present position where under the right in certain spheres is exercised by the State authorities. It might be argued that since some of the States consider Stamp Duty as an important source of State revenue, they should have the freedom to adjust the rates to meet revenue exigencies.

We may here mention a practical difficulty experienced by the general public. It sometimes happens that the Registering authorities in a particular State refuse to allow admission of execution of a document, for example a power of attorney, drawn on a stamp paper of another State where the document is to be made use of, when presented for admission by the person residing within the jurisdiction of the former. This causes a good deal of avoidable hardship. It should be made obligatory on the Registering authorities to admit execution of documents, irrespective of the documents being drawn on stamp papers of any other State, provided that the stamp duty required to be paid on the document presented for admitting execution has been duly paid.

Question 163.—*Certain States (e.g., Bombay) levy stamp duties on transactions in forward markets. What is your view re: the complaint that these duties have tended to affect the business in these markets, particularly that of the middle-class traders? If you consider that the levy of stamp duty on transactions in these markets is a suitable and potentially important means of securing revenue, what administrative and other measures would you suggest for the efficient collection of such duties? Alternatively, in place of stamp duties, would you suggest some other form of taxation of transactions in stock exchanges and futures markets? If so, please elaborate your suggestion.*

We would like to trace the progress of the levy of Stamp Duty on forward market transactions in the State of Bombay from time to time. Before the year 1932, Stamp Duty was levied at the rate as. 2 for every Rs. 10,000 a.v. on Stock Exchange transactions. In April 1932, it was doubled by making the levy of as. 2 applicable to every Rs. 5,000 a.v. and the levy at that rate continued till March 1938. In April 1938, it was again doubled by making the levy of as. 2 applicable for every Rs. 2,500 a.v. On 1st January 1944, a surcharge of 50 per cent. was added, making the rate of as. 3 applicable for every Rs. 2,500. From 1st April 1950, the effective rate has been as. 2½ for every Rs. 2,500, and even on that basis the rate is more than four times the rate in force when the duty was first introduced. Incidentally, we would like to point out that the rates of stamp duty in the different States for purposes of stock exchange transactions vary. The Bombay rate

is the highest. This inevitably leads to a certain amount of diversion in activities from one centre to the other. In the case of Cotton transactions, stamp duty was introduced in the year 1948 at the rate of as. 6, including a surcharge of 50 per cent. per unit of 50 bales. In 1949, the stamp duty was extended to transactions in the Bullion market, and is being recovered so far as Silver is concerned at the rate of as. 3, including surcharge for every unit of 2,000 tolas, and as. 12 for every unit of 250 tolas of Gold. Government have also armed themselves with general powers to apply the stamp duty to transactions in the Commodity markets.

We had in the past drawn pointed attention of the authorities to the consequence of the levy. We had stressed that the tax would prove to be a check on the frequency of transactions. In the light of the changes that have taken place, resulting in a substantial reduction in the turnover in the forward markets, the claim of the trades, represented in the different forward markets, which have been successively pressing on the attention of Government for a review of the position as a whole, is on strong grounds. Forward markets have their own importance in the organisation of modern commerce and industry, and the high rate of stamp duty is understood to be a contributing factor for a reduction in the volume of business in the Stock Exchange.

So far as cotton is concerned, the same supply of cotton has to pass through many stages, and under the present arrangement it is subjected to duty at every stage, with the result that the cumulative effect of the levy is a substantial burden. Jobbing is an important feature in forward markets and gives a healthy tone to the transactions in the markets. The duty has proved to be a deterrent on the frequency of jobbing transactions, and as a consequence the volume of the business has been restricted to a great extent. We would also like to point out that the present position and practice of recovering the duty on both the stages, viz., the stage of purchase and the stage of sale, should be changed and the duty should be recovered only at one stage. The present practice results in one and the same transaction being taxed twice over. The duty on *badli* transactions should be only 50 per cent. of the basic rate, as *badli* transactions are in the nature of a contribution of the original one. Under the present arrangement, a *badli* transaction is charged as an ordinary purchase or sale transaction. No stamp duty should be leviable on *tara-vani* or jobber transactions. The tax should apply only to transactions between the client and the broker. *Taravani* represents quick alternative purchases and sales in order to help the smooth flow of trade from the original sellers to the ultimate purchasers. It is neither fair nor equitable to levy a tax at each such stage. The restriction in the frequency of transactions has an additional disadvantage. It throws out of work a section of the middle-class population who were normally being sustained by increased activity in the exchanges.

Question 164.—*In this country, the stamp duty is ordinarily a tax on documents which constitute evidence of legal rights. There are, however, certain taxes, such as the entertainments tax, which are sometimes collected in the form of stamps, and suggestions have been made that this system may be appropriately extended to the collection of taxes on the sale of goods or on other transactions. Do you agree with this view? If so, to what taxes would you extend the scheme?*

We do not consider the system of recovery by stamps to be a suitable method for collection of taxes on the sale of goods or other transactions. In such transactions, the liability for payment of tax arises at a prescribed point of time, quite after the transactions have taken place, as for example in the case of sales tax at the end of each quarter or at the end of a fixed period as the case may be. If payment through the medium of stamps is introduced, it would mean that the amount of tax would in effect have to be paid much in advance of the transaction, for the dealer would have to pay for, buy and keep in his possession supplies of stamps long before the transactions, for which tax payments have to be made, are effected.

Question 165.—*What are the more common methods of evasion or avoidance of payment of stamp duty? What means of prevention would you suggest?*

In the case of stamp duty attached to documents, we do not envisage the possibility or chance of any evasion, for the appropriate official authority would be checking the documents in question and impounding the same whenever any deficiency is noted. There are also provisions for penalty for under-stamped documents. The Courts also do not admit documents in evidence if they are not properly stamped. This automatically has the necessary deterrent effect. In the case of transactions in forward markets, the high rate of stamp duty is leading to certain stages of the transactions being kept on an informal basis, so as not to attract duty. The remedy there is to reduce the rates of duty and thereby discourage the practice of certain stages of the transaction being conducted on an informal basis.

In the case of adhesive stamps, the arrangement in regard to defacing of stamps should be more thorough. Carelessness in defacing stamps may lead to the same stamps being abstracted and used again.

Question 166.—*The rates of Court Fees differ from State to State. To what extent do you consider uniformity in the rates desirable and feasible?*

The rates of Court Fees differ from State to State. Different States have amended the Schedule to the Court Fees Act, and have also passed Acts imposing surcharges on Court Fees payable under the Schedule. As is the case in respect of stamp duty payable on documents, in regard to Court Fees also uniformity is desirable not only in regard to the general principles, procedure and method of realisation but also in regard to the rates at which the Fees are levied. The existence of a large difference in the rates as between the different States engenders a feeling of injustice in the person affected. Where a cause of action has accrued in more than one State, there will be a tendency to take proceedings in that State where the Court Fees are the lower. While uniformity is desirable, there may be practical difficulties in enforcing such uniformity. The scale of Court Fees may be fixed in a manner as to cover the cost of administering the law by the State concerned. Since the rate of expenses may vary from State to State, there are limitations to achieving general uniformity. The States may be required to follow the Schedule of Court Fees fixed by the Central Legislature, but they may be given power to enhance the rates or levy a surcharge within a ceiling fixed by the Central Act.

Question 167.—*Have you any suggestions to make re: the Schedules to the Indian Court Fees Act and the rates of levy thereunder?*

The Schedules to the Court Fees Act, in addition to providing for the fees payable in Courts, deal with various miscellaneous fees leviable by Revenue and other officers. While the rates of Court Fee payable in Courts should be on a uniform basis as far as possible, there is no justification for levying any Court Fee in respect of matters before Revenue and other officers, and the system of levying fees for such purposes should be abolished. It is anomalous that fees on applications before Customs, Income-tax and such other Revenue authorities, functioning under the Centre, should be by means of Court Fee stamps issued by the State authorities.

TAXES ON MOTOR AND OTHER VEHICLES

The Motor Vehicles Taxation Enquiry Committee have dealt with, in great detail, the defects and drawbacks of the existing scheme of taxation of motor vehicles. The Committee have pointed out that the motor vehicles taxation in India is the highest in the world and have traced the stages by which the various taxing authorities, viz., the Centre, the States and the Local Authorities have been imposing increasing burdens on the motor vehicle user from time to time. They also deprecate the tendency to treat motor vehicles as items of luxury for purposes of taxation both by the Centre and by the States. Under the present conditions of work and life, motor vehicles come in the category of necessities of life. The present level of taxation is responsible for the low *per capita* ownership of vehicles in this country. The checks on the capacity to own and run a vehicle imposed by the present scheme of taxation also throws a handicap on the growth and development of the automobile industry. The enormity of the burden can be realised from the findings of the Committee that the average goods lorry pays by way of Central and State Taxes alone twice the average earnings per ton mile of goods carried by rail. The existing tax incidence is composed of distinct or separate levies under the following heads or categories:

- (1) Customs and Excise duties levied by the Central Government.
- (2) Petrol tax or fuel tax levied by the Central Government.
- (3) State Petrol Tax, Motor Vehicles Tax, Sales Tax on Motor Vehicles and accessories, and registration and other fees levied by the State Governments.
- (4) Octroi duty, Terminal Taxes, Tolls, Fees, Wheel Tax, Vehicle Tax other than Motor Vehicles Tax, Road Tax, Road Cess, etc., levied by Local authorities.

The Motor Vehicles Taxation Enquiry Committee estimated that the annual taxation on a light passenger car in the State of Bombay amounted to Rs. 953, on a medium car to Rs. 1,612, on a motor lorry to over Rs. 5,000 and on a bus to Rs. 6,444. Since then, the rate of provincial taxation was increased in Bombay in the year 1952 in a substantial manner.

There is overwhelming support for the point of view that the present burden of taxation is coming in the way of expansion of motor transport and this form of transport is playing its proper role in the development and progress of the economy of the country. There is

a strong case for relief and in reviewing and suggesting re-adjustments in the existing basis and scheme of taxation of motor vehicles, the Commission will naturally, give due consideration and importance to this claim for relief from the present level of taxation.

Question 168.—*Taking into account (a) the several taxes Central, State and Local, which affect motor transport directly and business, trade, etc., indirectly, (b) the variation in some of these taxes from region to region and between different categories of vehicles and (c) the relative financial needs of the different taxing authorities, both generally and, in particular for the maintenance, improvement and extension of roads, what changes, if any, would you introduce in the present system of motor vehicles taxation? What degree of uniformity do your suggestions involve? Instead of several taxes by different authorities, a consolidated tax has been suggested: do you consider this feasible? How would you apportion the proceeds among the different authorities concerned?*

We would advocate a uniform scheme of motor taxation applicable to the country as a whole. There is no difficulty so far as the taxes levied by the Centre are concerned, because such taxes operate on a uniform basis. So far as the States are concerned, State taxation should be confined to two heads, viz., State Fuel Tax or Petrol Tax and the State Motor Vehicles Tax. All other taxes by the State as also by the Municipal authorities should be abolished. State Sales Tax on petrol should be merged with the Central Petrol Tax and collected by the latter.

Apportionment of the proceeds of the consolidated petrol tax should be by a formula linked to petrol consumption in each State. A weightage may be given for meeting the requirements of underdeveloped areas and for assisting special road programmes approved by the Centre. Provision will also have to be made for compensating Municipal and Local authorities for the loss of revenue on account of Wheel Tax and Octroi and the basis of compensation should be linked to the expenditure to be incurred by such authorities for the upkeep of roads in their charge.

Question 169.—*To what extent and in what manner, in your view, should the proceeds from motor vehicles taxation be earmarked for road maintenance and development?*

As mentioned earlier, the divisible portion of the proceeds of consolidated Petrol Tax should go to the different States in proportion to the petrol consumption in the respective States. The share of the proceeds of used only for purposes of road development. The States Motor Vehicles Taxation Enquiry Committee, to a non-lapsing road fund, and the money in the fund should be used only for purposes of road development. The States should also continue to contribute from the General Revenues for community use of roads as they have been hitherto doing and such contributions should also go to the credit of this non-lapsing fund.

Question 170.—*Have you any specific comments to make on the main recommendations of the Motor Vehicles Taxation Enquiry Committee, 1950?*

We are in general agreement with the main recommendations of the Motor Vehicles Taxation Enquiry Committee. In particular, we endorse the suggestions made therein for assisting the pace of road development.

Question 171.—*Have you any suggestions to make regarding the extension of taxation to, or increase of present taxation on, users of roads other than motor vehicles? How would you classify the users, what rates would you suggest and who, in your view, should be the taxing authorities? How would you dispose of the proceeds?*

As the general tax-payer is expected to contribute to a moiety of the expenditure for the upkeep of roads for the community use of such roads, we do not consider that users of roads other than motor vehicles need be called upon to pay the special or additional tax. Suggestions have been made in the past, which suggestions have also received the support of the Motor Vehicles Taxation Enquiry Committee, that bullock carts, used as public carriers, should be required to pay a special tax for the use of the roads.

Entertainments Tax

Question 172.—*This tax is usually levied on tickets of admission to entertainments or amusements, of which the cinema is by far the most important. In this regard, the Cinematograph Industry Enquiry Committee considered the incidence of the tax on the industry too heavy. Do you agree with this view and, in particular, do you consider that the rates have reached the point of diminishing returns?*

The Committee also suggested uniformity in the rates of duty which differ widely from State to State.

Do you agree with this view? If so, how should it be achieved?

How far would you apply graduation in the rates of entertainments tax?

What modification in the system of levy would you suggest?

We are in general agreement with the views expressed by the Film Enquiry Committee that the burden of the Entertainment Tax on the Film Industry is very heavy and that the rates have reached the point of diminishing returns. The observations of the Film Enquiry Committee equally apply in so far as the effect of the tax on other forms of entertainments are concerned. Apart from the steep progression in the rates of the tax, as commented by the Film Enquiry Committee, the present method of assessing tax on the basis of the net amount paid to the theatre owner, instead of the gross amount paid by the public, is leading to anomalous results. For instance, under the existing arrangement, if an Exhibitor in Bombay wishes to raise his share of the admission price from 4 annas to 6 annas, he will have to raise the price of the ticket from 5 annas to 8½ annas, i.e., for an effective increase of 2 annas in the price yield to the Exhibitor, the gross increase has to be of the order of 3½ annas. The rate of the tax has also been substantially increased between the years 1938 and 1953. In Bombay, for instance, for a ticket priced between Re. 1 and Rs. 2 the tax was 4 annas in 1938; at present it is 10 annas, and for a ticket priced between Rs. 4 and Rs. 5 it was 12 annas in 1938 and it is Rs. 2 at present. The effect of the present level of tariff is reflected in the collections from Entertainments Tax in the three major States during the last three years:

Collections of Entertainments tax
(In lakhs of Rupees)

Year	Bombay	Madras	West Bengal
1950-51	172.85	123.89	105.02
1951-52	177.0	126.39	109.77
1952-53	156.88	119.28	104.33

It may also be generally stated that the burden of the Entertainments Tax has been, to some measure, responsible for the comparative elimination of the Musical and Dramatic form of entertainments. We are entering a period of general depression in activities and the set-back caused by the present level of the incidence of the Entertainments Tax would be more evident in the years to come. There is, therefore, a strong case for a substantial scaling down of the present rates of the Entertainments Tax.

It is desirable to achieve a large measure of uniformity in the rates of duty which, at present, vary widely as between the different States. In view of the constitutional position, the Centre should, through the machinery of the periodical Finance Ministers' Conferences, exercise friendly and informal pressure on those guiding the destinies of the States to bring about uniformity by common agreement. At any rate, the States must be persuaded to agree to the upper and lower limits of the rates of duty, as also the basis of the levy viz., whether it should be a specific rate or an *ad valorem* rate. If uniformity in regard to all aspects of details is not found possible, at least if there is agreement on the ceiling to be fixed and on the basis of the levy, a good beginning may be considered to have been made.

We are not in favour of a system of graded rates. We share the view expressed by the Film Enquiry Committee that an *ad valorem* basis of levy representing a specified proportion of the price charged for the ticket would be desirable. However, if, ultimately, some gradation is considered unavoidable, the gradation should also be on the basis of an *ad valorem* percentage rate, i.e., tickets upto a prescribed value bear a specified percentage of the value as duty and tickets over that value bear a specified percentage of the higher value as duty.

As mentioned earlier, the present rates of the levy are high and are having a regressive effect. The Film enquiry Committee had suggested that the tax should be fixed at the level of 20 per cent. of the gross takings. Even that rate, in our opinion, would be heavy. In the altered economic conditions now emerging, we believe that the rate should not exceed 12½ per cent. of the gross takings for all categories of seats.

Question 173.—What principles would you adopt in regard to exemptions? Should the criterion be:

(i) character of the entertainment (e.g., educational film);

(ii) nature of object to which net receipts are applied (e.g., charity show);

(iii) class of persons admitted to entertainment (e.g., lowest class of ticket);

(iv) any other factor?

The general consideration which should weigh in determining the policy governing exemption should be that wherever collections from the entertainment are not intended for private benefit and the scope of the activity connected with the entertainment is not of a commercial character, the same should not be attracted by the levy of the tax. Judged from that standpoint, (i) entertainment by educational films should be exempt; (ii) entertainment for furthering any cause ensuring to public benefit, e.g., assistance to charity, should be free (iii) entertainments organised and conducted by Societies and Clubs for the exclusive benefit of their members should be free from tax liability, more so when the sale of tickets to outsiders is not intended and the right of admission is strictly limited to members. There are many Associations working in the sphere of promotion of art and culture, functioning for the purpose of encouraging and advancing the finer arts, such as music, dance, drama, etc. The present procedure and practice is that, apart from the tickets sold to outsiders on such occasions being taxed, the Association or the Club is again taxed on an assumed gate-money calculated with reference to the number of members who had attended although the entertainment might have been free for members.

The present procedure in some States of attaching some tax liability to complimentary passes is not justified. However, to check the number of free admissions, a maximum number for a particular show or entertainment may be fixed. Regarding complimentary tickets, the position, at any rate, in Bombay is that such tickets are calculated for purposes of liability to tax. If that position is to continue, a minimum number of complimentary tickets should be excluded. Complimentary passes upto a prescribed minimum should be free.

Apart from complimentary passes, even admission of special guests by invitation appears to attract tax. This is not proper. The organisers of an entertainment may find it necessary to invite a large number of distinguished persons, having regard to the circumstances connected with the entertainment to a particular event. Just because general admission to such entertainment is by tickets, the presence by invitation should not be taken into account for arriving at tax liability.

Question 174.—How important is evasion of the entertainments tax and what methods of evasion are practised? What steps would you take to minimise evasion? Should there be a restriction on the number or proportion of complimentary tickets issued? Should collection be more generally by stamps?

From the nature of the organisation of the Cinema industry particularly, the scope for organised efforts to evade tax liability appear to be limited. There are two essential agencies involved in checking independently the collections from a show. The distributor is interested in finding out the actual number of persons who have attended the show, for his share of the takings, and the same will have to be determined by reference to such day-to-day or periodical check. The Exhibitor, naturally, will not give a set of figures to the tax collecting authority different from that given to the distributor. The existence, thus, of an automatic check in the organisational set-up as above, reduces, we feel, the chances of anything like a system of organised evasion. Moreover, if the rates of the duty are reduced, the inducement to evade will also be absent.

Question 175.—Would you suggest the extension of the scope of application of the tax to any other organised and conveniently taxable forms of entertainment not taxed at present? Would you recommend the exclusion from the scope of the tax of any kind of entertainment which is taxed at present?

All forms of entertainments which have a commercial significance are at present taxed. Moreover, even entertainments organised by Associations functioning for public benefit are also taxed. There is, therefore, no scope for extending the tax to more forms of entertainment. On the other hand, there is a strong case for exempting entertainments designed primarily for the purpose of developing the cultural side of social activities. In that category dramatic performances, and musical concerts particularly, when organised by non-profit-making bodies, should be completely exempt.

Tax on the Consumption or Sale of Electricity

Question 176.—A tax on the consumption or sale of electricity is levied in several States in India? Do you consider that this is a suitable tax and may be adopted by other States? Would you restrict it to consumers of energy for domestic purposes or would you extend it to sales for industrial uses also?

A direct tax in the shape of an Electricity Duty on the consumption of electrical energy was first introduced

in the State of Bombay in the year 1932, then as a temporary measure. It was confined to domestic consumption of electrical energy till the year 1948. The tax is since then being imposed in a number of States. Its incidence and scope vary from State to State and what is more, even in the same State they vary from area to area. The magnitude of the changes in the rate and scope of the levy is indicated by the fact that whereas in the year 1938/39 the total yield from Electricity Duty was only Rs. 18 lakhs, it rose to Rs. 85 lakhs in the year 1948/49, i.e., nearly five times over. From 1949 the tax is being levied on energy used for industrial purposes also and from that year onwards there has been a sharp increase in the revenues from this source. It has gone up to Rs. 200 lakhs in the year 1953/54 as against Rs. 18 lakhs in 1938/39, an increase of over 11 times. It must also be prominently noted that the diversity in rates and scope as between the different States introduces an unhealthy element of unequal conditions in regard to the functioning of enterprises and undertakings. In Bengal the duty is charged only on energy used for domestic purposes. In Orissa and Delhi, there does not appear to be any duty on electricity. In Madhya Pradesh the duty is only for domestic consumption. So far as Madras and the U. P. are concerned, the rates are considerably lower than those in force in Bombay. In fact, the incidence of the duty is the highest in Bombay.

The duty on electricity used for industrial purposes has been considered to be a tax on "an initial instrument of technological development". The rate for this levy is three pies per two units against the normal price of six pies per unit charged to the ordinary industrial consumer. So in the case of the average ordinary industrial consumer, the increase amounts to a 25 per cent. surcharge on the cost of energy. Again the cost of power in itself is the highest in India in the world. It has been estimated that the duty at 1½ pies per unit represents an increase in cost to the extent of 33½ per cent. in certain cases according to the tariff applicable to special loads and connected factors. Such a heavy impost on electricity consumed for industrial purposes is inconsistent with the overriding need, at the moment, for reducing cost of manufacture and increasing production.

The tax on the consumption of electricity for power purposes, in our opinion, is not a suitable tax and it should be abolished wherever the same is in force. In the case of energy consumed for domestic purposes also, the tax is deemed to be a levy on health and the normal minimum amenities of the average citizen. If the levy has to be continued, it is to be kept at a nominal level, there being an initial tax-free slab so that the smallest type of domestic consumers are not attracted by the same. In the City of Bombay, no duty is payable on consumption of energy below 12 units per month. This may be increased to at least 18 units.

While on this, we would like to bring to the notice of the Commission that there is an overwhelming support for the point of view that the present practice of levying a fixed sum per unit rate basis, should be replaced by a percentage basis of levy, computed with reference to the selling price of energy. Such a procedure is advantageous from practical considerations.

Question 177.—*In respect of domestic purposes—*

(a) *should a distinction be drawn between the electrical energy consumed for lights and fans and the energy consumed for other domestic purposes (fridges, heaters, radios, etc.)? On what principles would you determine the rates of duty?*

(b) *what exemptions would you suggest and on what basis? Would you apply a lower rate of duty to small consumers?*

(a) The connotation used for domestic purposes, perhaps, requires to be reconsidered. By reason of the provision for household amenities, the use of many labour-saving equipments is common and even as it is, the energy used for such purposes now is not chargeable at the same rate as that used for residential purposes, viz., lights and fans. Thus, the distinction is in force even now and energy used for such household equipment is on the lower basis applicable to industrial use. As mentioned earlier, we are not in favour of duty on consumption of electricity. If the duty, however, is to continue, it should be confined to the consumption of electricity for residential purposes over a tax-free quantum and the rate for such consumption should be on a percentage basis and at all events, should not exceed 10 per cent. of the basic cost of the energy.

(b) We have already suggested that in the case of industrial consumers, there should be no tax. So the question of distinction for purposes of differential basis does not arise. We have also suggested that to give relief to the lower middle-class and poorer sections of the society, the duty-free quantum of consumption should be fixed at 18 units per month in a place like the City of Bombay.

This tax-free slab should be available in the case of a consumer whose consumption exceeds the limit such consumer being liable only to the excess over the tax-free limit. The present practice is that when consumption exceeds the tax-free limit, the whole consumption is liable to tax.

Question 178.—*If you are in favour of a duty on energy used for industrial purposes, on what principles would you determine the rates of duty? What exemptions would you provide for and on what basis?*

If the duty is to be continued, the present practice of exempting undertakings controlled or owned by the State or Local authorities should go, as the discriminatory treatment of private enterprise is not at all justified. Again, as mentioned earlier, if in all cases where the duty is found to operate heavily, i.e., exceeds 10 per cent. of the total cost of production, the factory-owners should be exempted.

Question 179.—*How would you modify your suggestions in reply to the foregoing questions if electrical energy—*

(i) *is entirely supplied by Government undertakings in a State,*

(ii) *is supplied by Government undertakings in some areas of a State and private undertakings in other areas?*

(i) Electricity duty, if it is to be levied is a levy on the consumer and any distinction based on the ownership of the source of supply is irrelevant. Even where the generating or distributing undertaking is owned by Government, the principle or the basis governing the levy of the duty should remain the same.

(ii) The same consideration should apply in the case of areas where supply is through both the types of undertakings.

Question 180.—*What degree of uniformity as between different States would be desirable in regard to the levy of electricity duty? How would you achieve it?*

In our preliminary observations re: Q. 176, we have already indicated the unequal conditions created by the diversity in rates and basis of the levy of the tax. For example, enterprises and manufacturing undertakings located in a State like Bombay, having the highest rate of electricity duty suffers a handicap in regard to its competitive capacity vis-a-vis products of industries located in areas where the burden of the levy is substantially lower. Therefore, the need for uniformity particularly in the case of energy used for power purposes cannot be over-emphasized. By common consent or agreement, the different State Governments should be persuaded to levy a uniform rate of duty. Perhaps, this could be achieved by informal efforts made at the time of periodical conferences of Government representatives, in the Industrial Advisory Council or in other similar gatherings.

Betting and Prize Competition Taxes

Question 181.—*The betting tax is confirmed in practice to horse racing. Have you any suggestions to make regarding the rates of betting tax, the manner of levy of the tax, and the measures which may be adopted for minimising evasion of the tax?*

The primary consideration which should weigh with the authorities in regard to the basis and scope of taxation on betting should be that the level of taxation should not be such as to have a regressive effect on the activity as also to ultimately eliminate the same. Being pastimes of a luxury character, in principle the taxation of these activities may not be objected to. But the rate of tax should be reasonable and in any case should not be such as to produce a discouraging effect on the conduct of the activity as such. So far as betting through the medium of racing is concerned, there are two or three types of taxes. There is, firstly, a licence fee charged to the recognised Turf Club. This was first introduced in 1939/40. The annual fee charged was Rs. 3 lakhs in Bombay. It has been subjected to successive increases and at present it is of the order of Rs. 12½ lakhs. There is then the tax on admission to the Race Course, in the nature of a surcharge on the ticket. Admissions to the race course are taxed in Bombay at the rate of 37½ per cent. *ad valorem*. Then again racegoers themselves pay a tax in the shape of a levy on the stake amount. In 1939 the rate was 4 per cent.; in 1943/44 this was raised to 8 per cent., in 1948/49 it was again raised to 10 per cent. Government are armed with powers to raise it up to 12½ per cent. Notwithstanding these substantial increases, so far as the Bombay State is concerned, during the course of the last Budget discussion, the Government spokesman gave the information that the revenue from this source, had declined. The suggestion made earlier that the level of taxation should not be such as to discourage or eliminate the activity is thus reinforced.

Question 182.—*Do you consider it practicable to extend the betting tax to other forms of betting? To which and how?*

We are not aware of any other organised and legal form of activity involving betting on a substantial scale. If licensed betting in other spheres on a substantial scale exists, the possibility of evolving proposals for taxing the same may be considered. Lotteries run under the control and supervision of the State offer possibilities of some additional revenue in this sphere.

Question 183.—Have you any suggestions to make regarding the tax on prize competitions, e.g., on crossword puzzles? To what extent is uniformity between States desirable in regard to rates, etc., and what steps would you take to bring about such uniformity? What suggestions can you make in regard to preventing evasion or avoidance of the tax?

It would be desirable to secure uniformity as between the different States in regard to the rates and the basis of tax on competitions and crossword puzzles. The diversity in rates and practices, it is noted, has led to such activity being transferred to areas where the obligations were found to be less onerous. In the case of Bombay, for instance, the revenue under prize competition was over Rs. 24 lakhs in the year 1951/52 and it has gone down to Rs. 13 lakhs in the year 1953/54, some major undertakings engaged in this activity having transferred their sphere. In their anxiety to tax this source to the maximum extent possible, the States concerned should take care to see that the higher rates charged by them do not ultimately result in the activity sought to be taxed being altogether removed from their tax jurisdiction. Perhaps, the introduction of the recovery of the tax by a system under which the competitor affixes the same in the shape of stamps on the coupon or the Entry form to be used, may result in minimising the chances of evasion.

Miscellaneous Taxes and Fees

Question 184.—Have you any comments or suggestions regarding any other taxes, cesses or fees (e.g., excise on opium, probate and succession duties, registration fees) not covered by Parts II to V of the questionnaire?

NOTE.—Questions relating to certain taxes levied by Local Bodies as well as State Governments are included in Part VI dealing with local taxation.

One general observation which we would like to make is that licence fee or fees for registration for purposes of any activity should be only on a nominal scale. The system of licensing for any activity or trade should not be used as a revenue gathering process. For example, when licensing for cloth trade was introduced in Bombay, there was a good deal of grievance that the scale of licence fees was abnormally heavy. After all the trade is being taxed in other ways. Fees for licence should be merely a formality and confined to cover incidental expenditure involved in issuing such licences.

Referring to probate and succession duties, with the introduction of the scheme of Estate Duty, the former levies are no longer justified and should go. At all events, if they are continued, payments by way of probate or succession duty should, as a matter of course, be allowed as full deduction in computing liability to Estate Duty.

PART VI.—LOCAL TAXATION

General

Local Self-Government is the very basis of democracy and the local bodies—city corporations, municipalities, district local boards and village panchayats—are the foundations of the stable structure of society. Our Constitution has laid great stress on this and the establishment of village panchayats has been listed as one of the directive principles of State policy. The finances of local bodies would, therefore, require increasingly greater attention in future as such a study of local finance assumes the utmost importance.

The services that the local bodies are required to perform are the following:—

- (1) Education,
- (2) Public Health and Sanitation,
- (3) Medical relief, and
- (4) Public works.

The Financial resources at the disposal of local bodies are of two kinds:—

- (1) Tax revenues, and
- (2) Non-tax revenues.

Tax revenue comprises of the following:—

- (1) Taxes on property,
- (2) Taxes on trade,
- (3) Taxes on persons, and
- (4) Fees and licences.

Non-tax revenue generally comprises the following items:—

- (1) rents of land, houses, rest houses and dak bungalows,

- (2) sale proceeds of land and produce of land,
- (3) fees and revenue from educational institutions,
- (4) fees and revenue from medical institutions,
- (5) fees and revenue from markets and slaughter houses,
- (6) fees and revenue from commercial undertakings, such as motor buses, tramways, electric supply, etc.,
- (7) interest on investments, and
- (8) Government grants.

Taxes on property fall under the following classes:—

- (1) tax on buildings and lands,
- (2) cess on lands, generally with reference to their use for agricultural purposes,
- (3) tax on unearned increment in connection with betterment schemes, and
- (4) tax in the shape of a surcharge on stamp duty on transfers of property.

Taxes on property are important in Madras, Bombay, West Bengal and Madhya Pradesh. Cess on land is the main source of the district boards. Betterment taxes are not of much importance financially. Surcharge on stamp duty, on transfer of property, is levied only in Madras State and by the Calcutta Improvement Trust.

Taxes on trade are mostly octroi and terminal taxes and are important principally in East Punjab, U. P., Bombay and Madhya Pradesh. Tolls have been abolished everywhere except in one or two States.

The principal taxes on persons now levied by local bodies are the following:—

- (1) taxes on circumstances and property in Madhya Pradesh, Uttar Pradesh, Bihar and Orissa,
- (2) tax on professions, trades and callings in Bengal, Madras, Uttar Pradesh, Madhya Pradesh and Punjab,
- (3) a tax on companies in Madras,
- (4) a tax on pilgrims in Madras, Bombay, Uttar Pradesh, Madhya Pradesh, Bihar and Orissa,
- (5) a terminal tax on passengers in Calcutta, and
- (6) a tax on motor bus passengers in Bihar.

Fees and licences are numerous and are levied by almost every municipality in India. This may be classified under three principal heads:—

- (1) fees for specific services rendered by the municipality such as private scavenging,
- (2) fees which are partly in the nature of luxury taxes and partly for purposes of regulation, such as licences for music, vehicles, dogs and other animals, and
- (3) licence fees, the primary object of which is regulation, such as fees for offensive and dangerous trades.

The position, so far as Bombay State is concerned, is as follows:—

At present there are three city corporations, viz., Bombay, Poona and Ahmedabad. Maxima and/or minima for certain taxes are laid down. Subject to these limits, the corporations have full liberty to levy taxes permitted to them by law without reference to Government. Local bodies other than municipal corporations, have no independent powers of taxation.

Before dealing with the questions relating to the local taxation, we would like to preface our replies by some general observations relating to the fundamental problems.

Local finance, and for that matter, finances in any sphere, have necessarily two equally vital aspects, viz., income and expenditure. Both are closely interrelated and interdependent. The study of local finance should not, therefore, merely be confined to the income aspect, i.e., sources of income like taxes, rates, fees, and grants-in-aid. It has necessarily to be correlated to the simultaneous study of the aspect of expenditure of the local bodies also. Unfortunately, the Local Finance Enquiry Committee, which went into the whole question of local finance, confined themselves mainly to the raising of more income only. They have based their observations on the present structure and basis of local bodies and have refrained from suggesting any structural changes in the present set-up of the local bodies to improve the finances available to local bodies, for fear that they were outside the scope of their terms of reference. For instance, during the course of the evidence before the Committee, it was pointed out that with the tendency to transfer of functions from district boards to State Governments and the policy of establishing panchayats in practically every important village, district boards will have very little work to do in the near future and the question of their abolition as a measure of economy was put to them. Again, in Uttar Pradesh, where a large number of village panchayats have been established, the question of co-ordination of functions between district boards and village panchayats had been referred

to the committee by the State Government. The Committee expressed no opinion on these points as they had to frame their recommendations on the basis of the existing structure of local bodies. Besides this aspect of overall importance, the Committee has overlooked another significant aspect of improving the financial position by economy and efficiency in administration. Even some of the members of the Committee themselves felt that this aspect should have been more thoroughly investigated by the Committee with a view to suggest measures to improve the machinery for budgeting, accounting, assessment and collection of taxes, recruitment and control of personnel, etc. If the Committee had probed into the above two aspects of local taxation, it would have not been faced with the only alternative of expanding the revenues by increasing taxation both in the matter of rates and the scope. It is hoped that these aspects will receive due consideration at the hands of the Taxation Enquiry Commission. The *per capita* tax paid to the local bodies is fairly high in relation to the services rendered. According to the estimates of the Local Finance Enquiry Committee, in the year 1946-47 the *per capita* local taxation was Re. 0-4-1 in rural areas, Rs. 4-11-10 in municipal areas and Rs. 18-12-3 in corporations. During the next 3 years local taxes were further increased by about 30 per cent. Considering the fact that the *per capita* total income of the people in India is very low and that land revenue is not included in the local taxation, the level of local taxation in India is understood to be more than that in many of the Western countries.

An important finding of the Local Finance Enquiry Committee is that the field and scope for taxation by local bodies in India is very limited and requires widening. Almost in all the States, the State Governments have encroached upon the field which was reserved for local bodies prior to the year 1935. The Government of India Act of 1935 repealed the rules regarding scheduled taxes which were previously reserved for local bodies. The Act provided for 3 lists, viz., Federal, Provincial and Concurrent. The previous 'Scheduled taxes' were included in the Provincial List without any indication that the taxes in question were reserved for local authorities. This change has proved rather unfavourable for local authorities, as State Governments have, in certain cases, utilised what were previously recognised to be purely local taxes for their own purposes.

This position continued in the new Constitution of India. Some of the former local taxes like the Terminal Tax are included in the Union List, while the majority are included in the State List. In some States, taxes on property and in others, taxes on professions, trades, callings and employments are being used for the purposes of the State, though proceeds were meant to be allocated to local bodies. Another disquieting feature of the present system of local finance is that the States have deprived the local bodies of their lucrative sources of revenue from the running of the public utility undertakings. Some big local bodies are best suited for transport services, electricity distribution, etc., which incidentally provide good revenue.

Thus left with a very few sources of income, the local bodies have to mainly depend upon grants-in-aid from the States. If the reasonable grants are not forthcoming, then the local bodies try to either increase the rate of taxes in the sphere of their jurisdiction or to expand the field of the existing taxation. Generally, the burden of the increased taxation is always sought to be imposed on the industrial or commercial sector out of the fear of opposition from the public if the same is broad-based. Thus during recent years, many municipal authorities have increased their rates of octroi duties or have roped in more and more commodities for taxation. In their frantic efforts in search for increased revenue, consideration is hardly given to the fact whether the industry or trade as a whole will suffer or not, with the result that the additional imposts greatly hamper trade and substantially add to the cost of production.

The Local Finance Enquiry Committee has, therefore, rightly recommended that the progress of provincialisation of tax resources should be checked and more and more sources of revenue should be made available to them. In order that the local bodies do not misuse their powers, they have also suggested certain safeguards such as statutory limits of maximum and/or minimum of taxes, etc. We are in general agreement with the committee in their suggestion regarding the reservation of the following taxes for the local bodies:—

Union List

- (1) Item No. 89:

Terminal taxes on goods or passengers carried by railway, sea, or air.

State List

- (2) Item No. 49:

Taxes on lands and buildings.

- (3) Item No. 50:

Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.

- (4) Item No. 52:

Taxes on the entry goods into a local area for consumption, use or sale therein (octroi).

- (5) Item No. 53:

Taxes on the consumption or sale of electricity (the rate should be nominal).

- (6) Item No. 55:

Taxes on advertisements other than advertisements published in the newspapers.

- (7) Item No. 58:

Taxes on animals and boats.

- (8) Item No. 59:

Tolls (if they are continued).

- (9) Item No. 60:

Taxes on professions, trades, callings and employments.

- (10) Item No. 61:

Capitation taxes.

- (11) Item No. 62:

Taxes on entertainments including amusements (within city or municipal limits).

This could be done by the centre persuading the State Governments to statutorily lay down that these particular items now mentioned in the State List be exclusively made available to the local bodies or by sharing the revenues from these sources in some fixed proportions. The item of Terminal Tax may be transferred to the Provincial List for local bodies by a change in the Constitution. As stated earlier, the local bodies should also be empowered to manage the public utility undertakings such as road transport, electric supply, etc., within their limits, to the extent that they have already been transferred to the public sector. All the above measures are suggested because, in our opinion, there is at present very little scope for increasing or expanding the existing sources or rates and scope of the existing local taxation. Many of the recommendations of the Local Finance Enquiry Committee to increase existing local taxation are, in our opinion, not justified.

Coming to the questionnaire proper, questions No. 185 to 199 which generally pertain to the powers of taxation of local bodies, transference of tax power from the State List to the local bodies, grants-in-aid, etc., are dealt with by the general observations made above. Our suggestions in this regard may be summarised as below:

- (1) Local taxes being generally in the nature of charges for services rendered, sufficient funds should be made available to them so that the essential services rendered by them may not be curtailed on account of lack of funds.
- (2) For this purpose, local bodies should not be made dependent upon grants from the State Governments as far as possible, but should have their own independent powers of taxation within fixed limits. It must, however, be provided that the same sphere should not be taxed by the two taxing authorities, viz., State Governments and Local Authorities. The State Governments should not be allowed to interfere with these powers. This could be done by statutorily laying down these particular sources of taxes exclusively for local bodies.
- (3) If in some cases this is not found feasible, then in those cases, a fixed percentage of revenue derived may be earmarked for the local bodies.
- (4) Grants-in-aid should be resorted to only in the last resort. Even grants-in-aid should be given on the scientific and pre-determined basis such as population, rateable value of properties, density of population, number of school-going children, etc. No departure from this standard basis should be made.
- (5) In so far as the existing system is due to the defect in the constitutional framework, the Constitution should be amended to that extent.

So far as matters of relative details are concerned, the local bodies and State Governments would be exhaustively dealing with them. We have, therefore, confined ourselves to the matters of broad policy.

Taxation on Properties

Question 291.—If the question of valuation was confined to the levy of urban immovable property tax by States and general property tax by local bodies, what basis would you adopt: capital value or annual rental value? Do you agree with the recommenda-

tion of the Local Finance Enquiry Committee that "there should be no change from the well-tried basis of rent to the more or less uncertain basis of capital value", but that where "municipalities are actually adopting capital value as the basis and there is no complaint, that basis may continue"?

Taxations on property are determined either on the basis of the capital value or annual rateable value of the property. The computation of the capital value of the property is a very complicated process and leads to a certain extent to corruption. Besides, the income on that basis would be highly fluctuating with the deviations in the capital value of the property from year to year. In recent years on account of the inflationary conditions obtaining in the country, the capital value of the property has risen by three to four times the pre-war capital value. It would, therefore, be unfair to levy taxes on the basis of this high capital value of the property.

The taxes on the basis of the annual rateable value of the property are in the nature of taxes on a national income. They even comprise taxes which are deemed to be income of a property owner with the result that he has to pay tax on taxes. The better and the more realistic method is to assess tax on the basis of rents actually recovered or recoverable. We are, therefore, in general agreement with the recommendations of the Local Finance Enquiry Committee "that there should be no change from the well-tried basis of rents to the more or less uncertain basis of value", but that where, "municipalities are actually adopting capital value as the basis and there is no complaint, that basis may continue".

At present in some of the States in India the alternative bases of assessment are in existence. The choice of the basis, however, does not lie with the owner of the property but is left exclusively to the judgment of the executive authority of the municipality. This, in our opinion, would induce the municipal authorities in these States to manipulate the basis according to their own choice and thus subject the property-owners to the highest possible tax. We, therefore, suggest that such alternative basis of computation should go and only rental basis should be retained.

Question 202.—As regards the urban immovable property tax, the Local Finance Enquiry Committee says in effect that, even though property tax generally should be left to be exploited by local bodies, it would be both expedient and suitable for the Government (i) to levy an urban immovable property tax when a municipality fails to levy a property tax in spite of a statutory obligation to do so or (ii) to continue to levy the tax when a municipality refuses to increase its property tax to the extent the State Government is prepared to reduce its urban immovable tax. Do you agree with this view? Have you any other comments to make on the urban immovable property tax? If you consider it a suitable form of taxation for the States, what modifications, if any, would you suggest in regard to exemptions, rates of levy, mode of assessment and procedure for collection?

At present Urban Immovable Property Tax is levied in two States only, viz., Bombay and Punjab. In Bombay, it is levied in the three cities, viz., Bombay, Poona and Ahmedabad. The receipts on this account have risen from over 100 lakhs in 1938-39 to Rs. 151 lakhs in 1953-54. The burden of the Urban Immovable Property Tax is not at present allowed to be passed on to the tenants by the enactment of the Rent Act. In the beginning Government had accepted the principle of reducing the rates of Urban Immovable Property Tax with the corresponding increase in the municipal tax on property, but afterwards, Government decided that where the municipal tax was 21 per cent. or more of the rental value of the property, the maximum rate of Urban Immovable Property Tax should be reduced by 2 per cent. only. Thus, when the rate of municipal tax was raised from 14½ per cent. to 17½ per cent. from 1st April 1952, Government reduced the rate of Urban Immovable Property Tax in Bombay from 7 per cent. to 5 per cent. only for properties whose rateable value was Rs. 2,000 or above and from 3½ per cent. to 2½ per cent. for properties whose rateable value varied between Rs. 500 and Rs. 2,000.

We are of the opinion that the property tax is a tax particularly suitable for exploitation for local bodies and it is, therefore, desirable that the State Government should withdraw from this field on the condition that an equivalent local tax is imposed by the municipality. The Local Finance Enquiry Committee also recommended that "in the place of the present optional provision for the levy of the property tax in the various Municipal Acts there should be obligatory provision as it is in the Acts constituting the City Corporations of Bombay and Calcutta. Should, however, any municipality failed to levy tax in spite of such statutory provision, the State Governments should have the power to levy tax at such

rates as they deem fit in any municipal area for the benefit of the municipality". The Committee, therefore, suggested that this power should be exercised by the State Government only when a municipality has refused the advice rendered to it by the State Government in the first instance.

In Bombay, the total burden of the tax on property, viz., Urban immovable Property Tax, the general property tax, the water tax, conservancy tax, lighting tax and various miscellaneous taxes is of the order of 29½ per cent. of the gross returns of the property owners derived from rents. This in itself constitutes a very heavy burden on the property owners and there is, therefore, a strong ground for an all-round reduction of the tax on property. The high incidence of the tax on property is also reflected from the fact that the building industry today is in a very depressed condition with the result that an acute housing shortage particularly in towns and cities is prevailing today. When any municipality refuses to levy a property tax in spite of the statutory obligation to do so, there may be good and valid reasons for a municipality to do so. The municipality may have a desire to provide a degree of elasticity to its tax structure and thus may leave a gap between the permissible rate and the actual rate which may be filled up later. In such circumstances it would, therefore, be not justifiable for the State Government to encroach upon local field and fill up this gap and keep the municipal income from these sources fixed and rigid. When once the Government have filled up the gap it would be very difficult for the municipal authorities to derive any additional income from the sources because the State Government may not always be willing to withdraw the additional impost because the relation between the Government and the municipality may not always be cordial if the parties in power are different in the two places. We are, therefore, not in agreement with the suggestion of the Local Finance Enquiry Committee that it would be both expedient and suitable for the Government (i) to levy an Urban Immovable Property Tax when a municipality fails to levy a property tax in spite of a statutory obligation to do so or (ii) to continue to levy the tax when a municipality refuses to increase its property tax to the extent the State Government is prepared to reduce its Urban Immovable Property Tax. It would be proper, in our opinion, if the field of the property taxes is entirely left only to the local authorities and State Governments withdraw from it. After all, local authorities are in the best position to measure correctly the burden of taxation on property-owners and thus left to themselves, they would be adjusting the rates as the exigencies of the local situation require, within the prescribed limits.

We would, therefore, suggest that the Urban Immovable Property Tax wherever it exists should be progressively reduced and be amalgamated with the general property tax levied by the local authorities.

One of the defects in the procedure for levying the Urban Immovable Property Tax in Bombay may be mentioned here. At present in Bombay the properties whose rateable value is below Rs. 500 are exempted from the Urban Immovable Property Tax. Properties of rateable value below Rs. 500 were assessed separately till 31-3-1952. The Bombay Finance Act, amended in 1948 providing for grouping of properties in a locality is since being applied to such properties. The amending Act provides that properties belonging to one owner and situate in one locality could be grouped together to determine the Rateable Value. The word 'locality' is so loosely interpreted that properties situate at a distance of nearly two miles are also grouped. The result is that the intended exemption of small properties is not effective and is not available in practice in many cases. We would, therefore, suggest that properties bearing separate numbers must be separately assessed.

MUNICIPAL TAX ON PROPERTY

Question 203.—What principles would you recommend for adoption in regard to the general property tax? Would you exempt rental values below a particular level? How would you deal with the properties of owner-occupiers or of charitable or educational trusts or of co-operative housing societies? What remissions, if any, would you give for vacancies? So far as new buildings are concerned, would you recommend exemption for the first few years after construction, with a view to encouraging house-building?

Exemption.—The recommendations of the Local Finance Enquiry Committee in this connection are as follows:

- (1) "There should be no exemption from the property tax merely on the ground of the annual value falling below a particular monetary limit. Such exemptions, wherever they exist, should be done away with."
- (2) "There is no reason for the continuance of the concession in regard to the levy of property tax in the Municipal Acts of Bengal, Bihar

and Orissa in respect of buildings, the costs of construction of which exceeds one lakh of rupees."

- (3) "In all cases where exemption is granted at the instance of the Government, an equivalent contribution should be paid by that Government to municipal funds."

- (4) "Where an actual service like supply of water is rendered, there should be no exemption."

In our opinion, the first two recommendations are in the nature of a retrograde step. Even at present, at various places, properties of annual rateable value below a particular money limit (ranging from Rs. 6 to 36) are exempt from taxation.

We are, therefore, of the opinion that the present practice of granting exemptions in the case of properties whose annual rateable value falls below a particular limit, is a healthy procedure and provides a welcome relief to the smaller property-owners. In India there are immovable properties which are owned and inhabited by persons whose means are so meagre that they are unable to make two ends meet. They are living below a subsistence level of existence. People in the mofussil areas are generally owner-occupiers. Many of their properties are not buildings but huts of the most primitive type. Again, there are widows, old disabled persons who own small houses in the mofussil. Tax on the properties of such persons would be most inequitable and regressive.

We would, therefore, suggest that the present practice of granting exemption to properties of smaller rateable value should be continued. The exemption limit should be fixed at the money limit of annual rateable value of Rs. 250 or below.

We are also not in favour of the suggestion that the concession in regard to the levy of property tax in the Municipal Acts of Bengal, Bihar and Orissa in respect of buildings, the cost of which exceeds one lakh of rupees, should be discontinued. The Municipal Acts of the above 3 States provide that where the actual cost of buildings exceeds one lakh of rupees, the percentage on the annual value to be levied in respect of so much of the value as is in excess of one lakh of rupees shall not exceed one-fourth of the percentage on rate ordinarily leviable on that class of property. Such a concession, it appears, was specially intended for jute mills and industrial concerns, when they were first started. It was also justified on the ground that Local Government services benefited residents more than industrial concerns. Thirdly, many large industrial holdings have their own sewage system. In England also, such a concession is granted to industries of mining, manufacture and transport but not to commercial properties. Government, however, compensated the local bodies in the case of such big establishments.

The apparent ground on which the majority of the Committee suggested the discontinuance of such a practice of exemption, was their anxiety for financial strengthening of the local bodies. We are, however, of the opinion that such a concession to the commercial and industrial properties should be made available in all the States and a compensatory grants-in-aid may be guaranteed to the local bodies for the losses suffered on this account.

We are opposed to the present practice of exempting Government properties from the local taxes, as it would amount to an unfair discrimination against the private enterprise. We are, therefore, in agreement with the recommendation of the Committee that no Government property should be exempt from local taxation and that in all cases where exemption is granted at the instance of a Government, an equivalent contribution should be paid by that Government to municipal funds.

Besides, there should be concessional tax on all properties which are not used for commercial or ordinary residential purposes. Thus, properties used for religious, educational, cultural and charitable purposes should be charged at the concessional rate.

So far as the properties of owner-occupiers are concerned this should be assessed on the basis of the rents of the properties situate in the neighbourhood.

Remission for Vacancies

The recommendation of the Committee in this respect is as follows: "In view of that fact that the major portion of the services rendered by local bodies such as street repairs, maintenance of roads, fire brigades, public lighting, drainage, street cleansing, etc., has to be performed whether the building remains occupied or not, there seems no justification for giving a greater remission than half of the tax due in all such cases. Remission should not be granted for available vacancy of less than 90 consecutive days in a year. No ratepayers who are in arrears should be entitled to vacancy remission."

In Bombay remission to the extent of $\frac{1}{3}$ of the property tax is granted for the properties remaining vacant for 60 consecutive days or more in a year. We suggest that the same practice should apply to properties in all the States.

Exemptions to the New Buildings

In order to give a fillip to the house building activity, exemption from all property taxes should be granted in the case of new properties for the first two years. New buildings are also exempted for the purposes of income-tax for two years in the beginning. At any rate if it is not found feasible to grant full exemption to the new buildings, at least a concessional rate of property tax should be made applicable to them.

PROGRESSION IN PROPERTY TAX

Question 204.—Should property tax be progressive? If so, how and to what extent?

The Local Finance Enquiry Committee was generally in favour of a progressive scale, adaptable at the discretion of the municipality concerned. They have also recommended, as stated earlier, the repeal of the provision of some of the Municipal Acts which provide that rates for property taxes should be regressive after the valuation reaches the level of rupees one lakh. They are also against the provisions of law existing in some of the States providing for the exemption from local tax, of properties on the ground of extreme poverty of the assesses or on the ground that the valuation is below a particular low minimum.

The cumulative effect of all these recommendations, combined with their suggestion to substantially increase the rates of property taxes almost everywhere, if accepted, would result effectively in obliterating the institution of private property to a great extent. It appears that, the main consideration that has led the committee to go in for progressive property tax, is the checking of the evils arising from unequal distribution of wealth.

We are strongly opposed to the idea of introducing a progressive element in the case of property tax in the local sphere to eliminate the evils resulting from the unequal distribution of wealth. Progression fits in with personal taxes and not impersonal taxes. Attempts to introduce progressive taxes on properties in the local sphere in many countries of the world have not met with success.

The advocates of the progressive property taxes in the local sphere are oblivious of the main principle of the 'ability to pay' which is implied in the system of progressive taxation. The local property tax correlates very badly with 'income' from property, much less with the local valuation of the property. In the case of valuation of properties on rental basis, particularly owner-occupied properties, it cannot be argued that the valuation has any relation to the actual income of the assessee. Again, even in the case of a rated property, the income derived by way of rents is no index of a person's ability to pay. If, for example, a property-owner has mortgaged his property, he will have to pay interest charges on the amount borrowed by him. In that case, if he were assessed on the same basis as others possessing similar properties but with encumbrances, the tax would impose an inequitable burden on him. Further, the whole procedure for the levy of local progressive property taxes, including the fixation of the grades, slabs and brackets is found to be more arbitrary and unscientific at the local level. The recommendations of the majority that progressive property taxes are desirable at the local level is, in our opinion, highly objectionable.

Eminent authorities on Public Finance are almost universally opposed to the adoption of the element of progression in the property taxes at the local level. Some of them have even opposed proportional taxes and have suggested that the regressive taxes on property would be most suitable. A recent authority on Public Finance says that "It is most desirable to have a local tax which does not exaggerate local disparities in wealth. This it will be noted, cuts out for local use progressive income taxes. A tax which is proportional or even moderately regressive is more appropriate for a local purpose than a progressive tax, etc." (Hicks: 'Public Finance'.) "The property taxes actually levied even on proportional basis perpetuate serious direct distributional injustice. Let us not pile errors upon errors and carry this injustice further." (Seligman: 'Essays progressive tax.' (J. R. Hicks, Hicks Lesser: 'The Problem of Valuation for Rating'.)

"The least hampering type of tax is the rather regressive tax to which everyone contributes, the sort of tax which we have considered desirable as a local tax on other grounds. The most hampering variety is the progressive tax." (J. R. Hicks, Hicks Lesser: 'The Problem of Valuation for Rating'.)

Question 205.—*What categories of local bodies should be empowered to levy property tax? What should be the extent of the power in each case, and what conditions, if any, should be attached to the exercise of the power?*

At present all the local bodies are empowered to levy property tax in India. The district local boards are levying the tax in the form of a fund cess while the village panchayats are levying the tax on houses. We are in favour of empowering all categories of local bodies to levy the property tax on the condition that minimum and maximum rates should be statutorily laid down by the Government. Within these limits the local bodies may be allowed to levy property tax. Again, suitable provision should also be made to avoid double taxation by way of taxation by more than one authority on the same property.

Question 206.—*Have you any suggestions to make in regard to the administrative machinery and procedure for the assessment and collection of the property tax in relation to the different categories of local bodies?*

The ideal system of assessment of the properties would be to have one Central Authority for the purposes of valuation of properties within the jurisdiction of all the local bodies. The State Government should establish such a body in the interests of uniformity and should also bear the expenses. Such an independent expert authority for valuation also exists in the western countries. At any rate, the whole system of valuation of properties should be rational, uniform and scientific. In the case of grievances, however, the property-owners should have a right of appeal to the higher authorities.

The administrative machinery and procedure for collection should be such as would cause the least possible harassment to the assessee. It should also be borne in mind at the same time that the expenditure on this account does not go out of all proportion to the revenue derived from it. Thus, the system of collection of local fund cess, with the revenue collections made by the revenue authorities, is most convenient and least expensive. In the panchayat areas, the panchayat authorities themselves would be in the position to arrange for collection of house tax, sanitation tax, etc., as they are best informed with regard to the financial position of the individual assessee. In the municipal areas the present system of allowing the rebate for punctual payment should continue. Interest at the ordinary rates and not at the penal rates should be charged on the arrears of tax. While admitting that the percentage of arrears is very high in India, we are opposed to the idea of vesting the local bodies with coercive powers, as recommended by the Local Finance Enquiry Committee, as such a power is bound to cause undue hardship to the assessee. In the rural areas, generally the collection of taxes of the local boards and panchayats is never punctual on account of the seasonal financial stringency of the agriculturists. In their case, no interest for the arrears should be made chargeable. Further, the local bodies should have the power to proceed against the movable properties, and not against immovable properties, for the recovery of their taxes and fees. No disqualification in the matter of election to the local bodies should be attached for the delay in the payment of the local taxes by any person.

SERVICE TAXES

Question 207.—*In so far as certain taxes usually known as "service taxes"—e.g., water, lighting, drainage and conservancy taxes—are levied along with, and on the same basis as, the general property tax by certain local bodies what suggestions, if any, would you make in regard to the rates of levy, collection, etc., of these taxes? Have you any comments to make regarding property and service taxes vis-à-vis port trust properties, railway properties, other properties of the Central Government and properties of State Governments?*

The present position is that in the majority of the States the service taxes, viz., water lighting, drainage and conservancy taxes are not self-supporting. Water supply is self-supported in all the States except Bihar and Orissa. Street lighting is not self-supporting in most of the States. In the City of Bombay lighting tax is not even permissible. Conservancy and drainage—drainage rate, latrine rate, scavenging tax and general and special sanitary cess in Bombay—are not self-supporting anywhere.

The principle of self-sufficiency in respect of the specific services is not laid down in any of the Municipal Acts, but seems to have been derived from the extension of the language used in those Acts. The relevant section merely says that the rate should be fixed in such a way that the receipts do not exceed the amount required for providing the services. They prohibit the diversion of the proceeds of such taxes to other purposes but do not lay down the converse proposition that the expenditure on such services must be limited

to such receipts and cannot be supplemented from general revenues, in case the yield is insufficient. Further, in some States where there are statutory limits laid down with regard to the rates of such service taxes, the acceptance of the principle of self-sufficiency would involve a drastic curtailment of those essential services. Further, at a time when the central and provincial taxes impose a very heavy burden on the tax-payer, increased taxation by the local bodies to make the services self-sufficient would prove unbearable. We are of the opinion, therefore, that the services need not be self-supporting; if in any year the income derived from the levy of a particular service tax falls short of the expenditure, it should be supplemented from the general revenues of the municipalities or from the increased grants-in-aid from the States. A special service tax may, however, be levied when the areas within the municipal limits are differently developed. They are also justified when an individual rate-payer derives a special benefit from it. But in the case of uniform development of all areas, the consolidated rates are desirable.

The present practice of calculating service taxes on the basis of rateable value of the property has not, in our opinion, been objectionable and therefore should continue. The taxes may be collected with the general tax to facilitate recovery and economy in expenditure. The fixation of maximum and minimum rates for these taxes in all the States would, in our opinion, be highly desirable and will curb to a certain extent the tendency, noticeable in some municipalities, to increase the rates to any extent they like.

Question 208.—*Do you consider that the system of local fund cesses (viz., cesses on land revenue, collected by the revenue administration and handed over to local bodies) is satisfactory in its operation? If not, what alterations, if any, would you suggest? Please deal with local boards and village panchayats separately, and specify the individual State or States to which your reply relates. In particular:*

- (i) *Are minimum and/or maximum rates of levy laid down? Are they, in your opinion, either too high or too low?*
- (ii) *To what extent are the cesses earmarked for different purposes (e.g., road cess, education cess, etc.)? Would you extend or curtail the system of earmarking? Should there be a general cess in addition to earmarked cesses? In what circumstances?*
- (iii) *To what extent do suspensions and remissions of land revenue affect the collection of the cesses? Have you any suggestions to make in this connection?*
- (iv) *Please deal with any special problems connected with local fund cesses in*
 - (a) *Part B and Part C States,*
 - (b) *areas in which zamindaris are newly abolished.*

The main sources of revenue of District Local Boards are the grant-in-aid and the local fund cess. At present in the State of Bombay local fund cess at the compulsory uniform rate of 3 annas per rupee of land revenue is charged and the revenue is exclusively made available to the local boards. No portion from this amount is earmarked for education expenditure. The collection of the local fund cess is the responsibility of the revenue officers in the village. The system, therefore, causes least inconvenience to the tax-payer and is most economical.

The Local Finance Enquiry Committee was of the opinion that the prevailing rate of local fund cess in the State of Bombay was sufficiently high and that, therefore, there was no ground for increase in the cess. We agree with this recommendation. In the case of loss of local fund cess on account of remissions of land revenue, the State should, in our opinion, make good the loss by giving increased grants-in-aid to the local boards. We are also in favour of the suggestion of the committee that the collection charges of the local fund cess being insignificant, the State Government should undertake this work without charging anything to the local boards.

OCTROI AND TERMINAL TAX

Question 209.—*Please state your views on the relative merits of octroi and terminal tax, in one or more of the forms in which they prevail in different parts of the country, from the standpoint of—*

- (i) *the local body concerned: e.g., revenue derived and, in comparison with it, cost of collection, size and complexity of administration, scope for evasion, etc.;*
- (ii) *the person who pays the tax; certainty as to amount payable and convenience of collection; and*
- (iii) *the trade, the consumer, etc., incidence and effects of incidence, in so far as these can be broadly assessed.*

Are octroi and terminal tax mutually exclusive systems, or would it be permissible and desirable, in certain circumstances, to combine the two systems?

On an examination of the relative merits of (a) octroi, (b) terminal tax, and (c) any desirable form of combination of the two, which particular alternative would you recommend for general adoption by local bodies? Do any constitutional or legal difficulties stand in the way of implementing your suggestions?

Octroi or Town duty is the cess levied by local bodies on the import of goods into a local area for consumption use or sale therein. It is levied on articles even of common necessities of life, which are included in the schedules framed for the purpose and permitted by the State Government. On the exportation from a town of dutiable goods the octroi levied on them is refunded. The local bodies have also to provide bonded warehouses for storage of goods in transit, for which a fee is levied.

At present octroi is in vogue only in the four provinces, viz., Bombay, U. P., Punjab and Madhya Pradesh. Octroi is a common source of income for local bodies. The burden, however, falls inequitably both on the poorer sections of the society and on trade and industry. The imposition of octroi creates artificial barriers in the free flow of trade and adds to the cost of production of industrial goods. For instance, the rapid progress of Ahmedabad Cotton Trade and Industry during the last fifteen years is, in some measure, due to the absence of octroi.

Terminal Tax

Terminal Taxes are taxes on goods or passengers carried by railway, sea or air. At present, they are included in the Union List. The proceeds of the tax are, however, assigned to the States under Article 269 of the Constitution. Taxes on goods or passengers carried by road are not covered by this entry. Such taxes will continue to be within the jurisdiction of the States. However, this entry does not debar the levy of tax on pilgrims travelling by road. Article 277 of the Constitution contains a saving Clause that any taxes which were being levied immediately before the commencement of the Constitution, viz., January 26, 1950, by any Municipality, District or other Local Authority, may continue to be so levied notwithstanding the fact that those taxes are mentioned in the Union List, until provision to the contrary is made by Parliament by law. Many municipalities which were previously levying the terminal taxes, are still continuing the levy even now. For an objective assessment of both octroi and terminal tax as forms of taxation, we cannot do better than quote the following remarks of the Taxation Enquiry Committee (1924) :

"In the form in which they (octroi and terminal tax) are levied in India, they offend against all canons of taxation. They are uncertain in their incidence. Their collection and the system of refunds, which form an essential feature of octroi, puts the person paying the tax to a great amount of inconvenience. Where they are imposed on the necessities of life as in India, they do not proportion the burden to the means of the payer and the expense of collection and the facilities for fraud are disproportionately large, with numerous bodies independently taxing trade, it is impossible to know what are the burdens trade is really carrying and quite impossible to ensure their being adjusted in any way fairly among different articles and goods. The popularity of these taxes is due to the fact that their incidence is shifted and that it very difficult to determine on which classes the burden ultimately falls. The collection of terminal tax through the railway agency has removed all the administrative difficulties inherent in a system of octroi and there is a tendency among municipalities to resort to the tax whenever they are in financial difficulties because the local authority can in this case transfer the odium of collection to the Railway Company. The tax is also very defective from the educative point of view, since it does not encourage sense of responsibility among the electors, who do not directly feel the burden of the tax. Sir Josiah Stamp sums up the case as follows :

'In my judgment, both theoretically and on the result of experience, no country can be progressive that relies to any extent upon octroi, which has nearly every vice.'

Of the two taxes, terminal tax possesses some obvious advantages over octroi. Firstly, there is no system of refunds in terminal tax and, therefore, the rates are much lower. The system of refunds in the case of octroi is introduced with a view to relieve it of some of its bad features, but in actual practice, no refund is obtainable until several days after the payment. This practice has in a number of places either created a new class of brokers who obtain refunds of octroi on payment of some brokerage to them or encouraged corrup-

tion among the staff who for a consideration allow the dutiable articles to pass through without any payment of octroi. Secondly, the collection in the case of terminal tax, being both by Railways and the Port Trust Authorities for a small consideration, the terminal tax is not very expensive in collection; collection of octroi, on the other hand, is both inconvenient and expensive.

Terminal tax has, however, its disadvantages too. Absence of provisions for refunds makes the terminal tax a transit duty to the extent to which the burden of the tax falls on non-residents. Besides, it is levied on all commodities, imports, exports and goods liable to the custom duties. To that extent, they are bound to interfere with the tariff policy of the country with all its national and international repercussions.

Both octroi and terminal tax as sources of revenues offend against all canons of taxation. By hampering trade and industry and by creating avoidable harassment, they have, in our opinion, done more harm than good. Despite the fact that they have been condemned by one and all, they still continue today. The diversity in their rates and the schedules in different States and in different municipalities in the same State, has often resulted in the unfair discrimination of trade and industry in different areas. The earlier therefore, they are abolished, the better for the economy of the country as a whole.

Question 210.—Does your examination lead to the conclusion that both octroi and terminal taxes are unsuitable as forms of local taxation and should, therefore, be abolished? If so, what substitutes would you recommend? Do you consider the suggestion that local bodies should be allowed to levy surcharges on sales tax feasible and desirable?

This, however, confronts us with suggesting the alternative sources for revenue which the abolition of the octroi and terminal tax would entail. In view however, of the recent origin and the high incidence of the sales tax levied at present in many States today, we are opposed to the idea of levying a surcharge on sales tax by local bodies. In other words, the overall burden on trade, industry and the consumers imposed by octroi, terminal tax and sales tax needs to be considerably lightened.

Question 211.—If your suggestions involve certain modifications in the prevailing forms of octroi or terminal tax, what are the changes you would recommend?

Question 212.—What rates of levy, exemptions, procedure for collection and for refunds and arrangements, if any, for "bonding" would you suggest?

Question 213.—Should the basis of assessment for octroi be ad valorem or by weight, etc.? How would you provide against procedural delays and difficulties?

We advocate the total abolition of both octroi and terminal tax on the grounds mentioned before. If, however, for some seasons, the total abolition is not found feasible and its existence in some form, for some time at least, is rendered necessary, the following modifications, in our opinion, would to some extent relieve these taxes of some of their worst features :

- (i) There should be in each State a model schedule for octroi. approved by the State Government and departures from this schedule should not be permitted except with the previous approval of Government. In framing the model schedule, the representatives of the commercial community should be consulted. The maximum and/or minimum rates should be laid down. The rates on necessities of life should be kept as low as possible. Rates on other articles should be fixed in such a way that they do not impose any substantial burden on the trade and consumers.
- (ii) All public utility and commercial undertakings of Government should be treated in the same manner as if they were conducted by private enterprise, as otherwise, the local bodies may be deprived of substantial revenue and the private enterprise may be unfairly discriminated. For instance, the annual loss of the Bombay Municipal Corporation on account of exemption to foodgrains imported by the Government of India was, for years, of the order of Rs. 15 lakhs. If, however, exemption is granted to the Government transactions, the Government concerned should make a contribution in lieu of such taxation.
- (iii) We are in favour of a system of octroi at lower rates without refunds as is prevalent in the Punjab. If this is not found feasible a machinery for easy and quick refunds should be devised.

An important point arising out of the definition of octroi may be brought here to the notice of the Commission. Octroi is levied on the import of goods into local area for con-

sumption, use or sale therein. Refunds are allowed when the goods are exported in the same conditions. Instances have been brought to our notice, however, that when commodities like gram, oilseeds, etc., are imported for processing and the processed goods are exported, no refund is allowed on the exports, on the ground that the goods are not exported in the same condition. Such a procedure in our opinion, is bound to create hardships to the processing industries situated in big cities and towns and would add to the cost of production. A more liberal interpretation of octroi would, therefore, eliminate the avoidable hardship. We, therefore, suggest that refunds on goods exported out of the municipal limits after being processed should be allowed.

- (iv) Adequate 'bonding' facilities should be provided by the municipalities for goods in transit. The fees levied for 'bonding' should be low and the same should not be allowed to partake of the nature of additional revenue.
- (v) We are in favour of assessing octroi on the 'maundage' basis rather than on 'ad valorem' basis. All goods should be uniformly charged on 'maundage' basis. The 'ad valorem' basis is rather arbitrary, and has been called as 'one of the worst features of the octroi' by eminent authorities like Prof. Findlay Shiras. Further, ad valorem tax upon necessary goods, produced by agriculture at increasing unit costs, is especially burdensome because the tax grows with the costs and becomes regressive in its effect upon low income groups as cost mounts. Complicated problems arise in determining the value and the scope for corruption becomes greater. Moreover, the prices are trade secrets and their revelation, which is inherent in a system of this nature, is likely to lead to serious abuses. A specific assessment on the 'maundage' basis on the other hand, would much simplify the assessment procedure.

Question 214.—Would an extension of the nationalisation of motor transport make it possible to adopt a simpler and more effective system of terminal taxes on goods transported by road?

The extension of the nationalisation of motor transport would not, in our opinion, bring about any improvement in the present system of terminal taxes on goods transported by road.

Question 215.—Have you any suggestions to make in regard to the better correlation of octroi or terminal tax with allied forms of State and Central taxation such as sales tax, excises and customs?

Commodities liable to customs duty should be exempted from octroi or terminal tax, as otherwise the multiplicity of taxes on any commodities would render its price prohibitive for consumers and would also add substantially to the cost of production. The overall effect of sales tax and excise duty should be examined before any commodity already liable to sales tax and excise duty is included in the octroi schedule. At any rate, the rate of octroi should be as low as possible on commodities which are also liable to sales tax and excise duty.

Question 216.—Taxation on goods carried by road is only one of the items covered by entry No. 56 of the State List, viz., "taxes on goods and passengers carried by road or on inland waterways". Have you any comments or suggestions to make in regard to the utilisation of this entry for purposes of local and/or State taxation?

We have no comments to offer on this.

Question 217.—Should the "Pilgrim Tax" levied by certain local bodies be more widely adopted? Do you consider that a suitable form of taxation on the floating population in the bigger cities can be devised?

'Pilgrim Tax' is a tax levied on the persons temporarily visiting a centre of pilgrimage or a centre where people congregate. A terminal tax on passengers in the form of pilgrim tax is in vogue in almost all the important pilgrim centres in this country. Such taxes are usually levied on railway tickets and are collected by the railways. Such taxes cannot be levied without the sanction of the Central Government, as they are included in the Union List of subjects. While the Government of India have been permitting levy of passengers' tax in pilgrim centres more or less freely, they do not appear to favour its levy in places which are not centres of pilgrimage. The Taxation Enquiry Committee had suggested that "a light terminal tax on passengers may be justified in the case of a large city on the ground that as a centre of trade or amusement or of public offices many non-resident persons come in

and make use of the amenities provided by the local governing body". A vast number of people who daily visit the city from outside the local limits enjoy the civil amenities provided by the municipalities but escape local taxation altogether. The general opinion seems to be in favour of taxing such floating population for the benefit of local bodies.

We have no particular objection to the levy of "pilgrim tax" on the above categories of floating population, provided the levy is reasonably small and the minimum necessary, approximating the expenditure in providing the additional facilities, and no undue hardship and inconvenience is caused to the passengers.

Question 218.—What are your views regarding the desirability and feasibility of a "poll tax" as a form of local and/or State taxation?

'Poll tax' in our opinion is not a practical proposition, as such a direct levy is bound to meet with a very strong opposition from the people. Besides, it is doubtful if the State Governments or Local Bodies would themselves accept 'poll tax' as an advisable form of taxation. They would prefer taxes which are less objectionable and which do not stir up popular opposition.

Question 219.—(a) Have you any suggestions, not already covered by your previous answers (e.g., on motor vehicles taxation), to make regarding the levy of taxes on vehicles, animals and boats for purposes of local and/or State taxation?

(b) Do you consider tolls a suitable form of local and/or State taxation? In what circumstances?

Regarding (a), we have no more comments to make on this than those contained in our previous answers on motor vehicles taxation.

Regarding (b), tolls are a survival of the old and vexatious form of taxes. They have outlived their utility, both on account of the hardships they involve on the vehicle owners and the heavy cost of collection and cumbersome method of collection. We, therefore, suggest that tolls wherever they are levied today should be abolished and a compensatory allowance may be given to local bodies from the receipts of the petrol tax.

Question 220.—The Local Finance Enquiry Committee recommends that the limit of Rs. 250 placed on profession tax by the Constitution should be raised to Rs. 1,000. Do you agree? Would you recommend the wider adoption of profession tax by local bodies and/or State Governments? Which categories of local bodies may suitably levy it, and with what safeguards? Should the levy be compulsory in certain cases, and if so at what minimum level? What modifications, if any, would you suggest in the prevailing forms of levy of this tax? What steps would you take for its better correlation with income-tax, from the point of view of incidence or for purposes of administration, etc.?

A tax on professions and trades has been familiar in India from very early times. In view of the fact that it encroaches on income-tax, constitutional limitations have been placed on the amount of tax which can be levied by a local body. Before the Government of India Act of 1935 came into force, however, there was no constitutional limit on the amount of the tax. Even the Government of India Act, 1935, at first did not provide for any limit on the amount. When, however, attempts were made by one province to levy such a tax on a graded basis of income, the Central Government became apprehensive of the conflict between such a tax and income-tax. Consequently, the Act of 1935 was amended and a maximum limit of Rs. 50 was fixed. This was raised to Rs. 250 by the new Constitution. Few municipalities which were exempted in this regard by the Act of 1935 were allowed to enjoy the exemption by the new Constitution also. So far as Bombay is concerned, no local body levies profession tax as such but some of them levy small taxes in the form of licence fees on specified trades and callings which are subject to municipal control. This tax is also levied by four or five District Boards. The income from this source is negligible. The Government of Bombay are of the opinion that profession tax can never be a source of much income owing to the disproportionately large collection charges.

In our opinion, the present maximum limit of Rs. 250 for profession tax is a fairly high limit and any further increase in it will lead to grave abuses by the local authorities. Whenever they are faced with financial dilemma, they will find profession tax a convenient source to fall back upon. In actual practice, many local bodies will, therefore, render this 'ceiling' limit to a 'floor' limit. Because, profession tax encroaches on the income-tax, it is desirable that the limit should be kept as low as possible. We are, therefore, not in agreement with the recommendation of the Local Finance Enquiry Committee that the limit of Rs. 250

placed on profession tax by the Constitution should be raised to Rs. 1,000.

Question 223.—*Have you any comments or suggestions to make on any items of local taxation not covered by the foregoing questions?*

Licence fees are another source of considerable income to all categories of local bodies in every State. These fees are levied in order to recover the cost of supervision and regulation of certain trades and callings and for granting certain privileges which impose a special burden on the municipal services. In the City of Bombay, licence fee is charged to a variety of trades and callings such as factories, hotels, slaughter houses,

markets, advertisements, hawkers, surveyors, plumbers and various others. The other municipalities and district boards have, however, a limited field for charging licence fees.

A licence fee, by its very nature, is different from a tax. A licence fee is levied for regulatory purposes and for recouping municipal expenses incurred on such regulation. The Courts would be entitled to interfere in the case of licence fees if they are harsh or unreasonable. The plea of unreasonableness would, however, be barred in the case of taxes. The rate of fees should, therefore, be strictly correlated to the overall expenditure incurred in regulation and supervision and should never be allowed to grow into a convenient source of additional revenue.



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MADRAS CHAMBER OF COMMERCE, MADRAS

(REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.)

PART I.—THE TAX SYSTEM

GENERAL

The questions raised are so comprehensive that it is not possible adequately to reply within the time limit given. This Chamber proposes, therefore, to confine itself to general observations.

It is considered that, in general, both direct and indirect taxation should be for one purpose only, namely, the raising of sufficient funds to balance the revenue portion of the budget. Capital requirements should be obtained either by borrowing, particularly in those instances when the purpose is for expenditure on capital account for remunerative enterprises, and by the imposition of Estate duty, where it is logical to utilise this tax on capital for capital expenditure only.

In assessing the income requirements, there should be provision for a slow but gradual increase in the standard of living. With this policy in view and having ascertained the annual requirements on revenue account, the Government should first determine the amount to be raised by direct taxation.

In assessing this, it is strongly recommended that the only realistic policy is that direct taxation should be based on the ability to pay with the main emphasis on the all important factor of encouragement of incentives to work, to save and to invest.

In the opinion of this Chamber direct taxation should not in ordinary circumstances, be considered for the purpose of reducing inequalities of income and wealth and the countering of inflationary and deflationary tendencies or the maintenance of the external balance of the economy.

The high rates of direct taxation on individuals since the war have greatly obstructed the saving or investment by the wealthier and middle classes and have practically removed all incentive to work after a certain level of income has been reached. This policy cannot but be harmful in a country where the future policy has been based on industrial development and increased production. It must be remembered that high taxation has been accompanied by a greatly increased cost of living and there can be but few middle class families who do not find it difficult to balance their own family budget.

In recent years it is apparent that tax evasion has very considerably increased and this must largely be due to the burden of tax now imposed both on the individual and industry. In spite of all that is said to the contrary, this Chamber prefers to believe that the majority of tax payers are honest, or would prefer to be honest, and this Chamber would not be surprised if in the event of a maximum rate of tax of, say 8 to 10 annas, being fixed for the higher ranges of income, tax evasion would decline and there might well be a considerable gain in tax collections.

Direct taxation on industry as distinct from individuals should follow the same principles and should permit of reasonable amounts being placed to reserves in order to finance the present day costs of replacement and sufficient to allow for future expansion. This Chamber is of the view that greater incentives should be given to industry for these purposes and recommends an increased rebate on the standard rate for all amounts not distributed by way of dividends.

Having based the direct taxation on the policy outlined above the balance required must be recovered by indirect taxation. In determining the scope and extent of indirect taxation, care must be exercised in seeing that it is so assessed as to enable Indian industries to compete with the products of other countries. It is essential for this country to export to the fullest extent possible and the price must be competitive.

State Controlled undertakings

This Chamber sees no reason why State owned Undertakings should not be conducted on lines similar to ordinary commercial enterprises. The price of their products should not be influenced by the requirements of the Government or State but it should be governed by the principles adopted by private enterprise namely :—

1. a reasonable return on capital invested
2. similar rates or taxation on profits should be imposed and
3. there should be a reasonable margin for transfer to reserves to cover replacement and expansion.

PART II.—DIRECT TAXES

INCOME-TAX

Residence

Question 46.—Do the provisions of the Income-tax Act (Sections 4A and 4B) regarding the determination of residence of various assessee, viz., individual, Hindu undivided family, firm, association of persons and company, require any modification? In particular, what is your view regarding the retention of the category described as "not ordinarily resident"?

Individuals.—This Chamber considers that no change is necessary except that in Section 4A(a) (iv), after the words "Income-tax Officer", there should be inserted the words "on application made by the assessee".

The following further Clause should be added :—

"Such satisfaction shall be communicated to the assessee within one month of application."

Hindu Undivided Family.—It is considered that the present Sub-section 4A(b) should be cancelled. Hindu Undivided Families, firms and associations should only be regarded as resident if the major part of the control is actually exercised in India.

Companies.—It is considered that Sub-Section 4A(c) should be amended so as to provide that the determination of the residence of a Company shall be based solely on where the control is exercised and Sub-Clause (b) to this Sub-Section, concerning the amount of income arising in India exceeding that arising out of India, should be deleted.

Not Ordinarily Resident.—It is recommended that the category of "Not ordinarily resident" shall be deleted and that it shall be provided that earned income actually earned outside India shall not be taxable in the hands of a person resident in India unless it is actually remitted to India.

Question 47.—Does the definition of "income" (Section 2(6C) require any modification?

It is considered that the definition of "income" in Section 2(6C) is satisfactory except that Section 2(6A) require amending *vide* the reply to Question 50 below.

The Second Proviso to Section 10(2) (vii), in so far as it seeks to levy a charge on profits made on the realisation of fixed assets after the cessation of a business, should be deleted unless it can be shown that the closing down of the business has not been *bona fide* but has been done with the intention to avoid payment of tax which would otherwise have been payable under the provisions of Section 10(2)(vii) if the business had continued.

Question 48.—Are there any receipts or gains which are not taxed at present but which, in your opinion, should be taxed and vice versa? In particular, what is your view regarding the taxing of capital gains?

(a) It is considered that lease premiums and paguee payments should be taxed in the hands of the recipient.

(b) It is considered that unpaid balances over six years old, when taken to credit in the accounts of a business concern, should be taxed.

(c) It is considered that gratuities paid by an employer arising from the death of an employee or his medical unfitness or retrenchment, due to no fault of his own, should not be taxed in the hands of the recipient.

As to the taxing of capital gains, Income Tax, by its very description, is a tax on income and therefore no attempt to tax capital should be made by introducing any provisions into the Income-Tax Act.

If the taxation of capital is ever necessary it should be effected by means of a separate Act specifically directed to that purpose.

Question 49.—Have you any comments on the present position regarding taxation of profits, which accrue or arise abroad, on their repatriation to India?

It is considered that the present concession concerning repatriation of funds from overseas should be extended to profits made in and still not remitted from the former native States of India, so as to encourage the bringing back of such funds into productive use.

Question 50.—What change, if any, is called for in the definition of "dividend" (Section 2(6A)); e.g., in relation to "bonus shares"?

It is considered that there is no necessity to amend Section 2(6A) in so far as that section concerns bonus shares because it has been clearly established by Case

Law that the capitalisation of reserves by the issue of bonus shares does not attract liability to tax in the hands of the shareholder.

In regard to Sub-Section (c) of Section 2(6A), this Chamber is of the opinion that the following further proviso should be added, so as to exclude public companies from the operation of the Sub-Section :

"Provided further that this Sub-Section shall not apply to a public company whose shares are quoted on a recognised Stock Exchange."

Question 51.—Do the provisions of the Income-tax Act relating to the taxability of non-residents through their business connections in India in respect of income deemed to accrue or arise within the taxable territories (section 42 and 43 of the Income-tax Act) affect adversely the interests of persons engaged in foreign trade? If so, what modification would you suggest in these sections?

Sections 41 and 42 of the Income Tax Act have always been regarded as amongst the most controversial provisions of the Act because they seek to assess the profit of a non-resident arising from a business connection in India. Levy of tax on the profit attributable to purchase of goods and materials is peculiar to India and it is understood that there are no parallel provisions in the Income Tax Laws of any other country.

"Business connection" is an abstract idea which is rarely understood by the assessee or by the Income-Tax Officer and assessments are invariably arbitrary. It is suggested that levy of tax should be based on the exercise of a trade in India and not on the existence of a business connection. This Chamber therefore suggests that the words "through or from any business connection in the taxable territories" be deleted from Section 42(1) of the Income-tax Act. Consequentially the words "or having any business connection with such person or" should be deleted from Section 43 and appropriate changes made in the provisos.

Further difficulties which have been encountered in connection with the application of the present Section 42(1) are :

- (a) the difficulty of ascertaining who should be treated as the agent where the non-resident has business connection in various States of India
- (b) the difficulty of realising the tax levied on an agent in respect of transactions carried out with ether agents in the country
- (c) the inequitable result of treating the agent as the assessee for all purposes of the Act and making him responsible for payment of tax due by the non-resident irrespective of whether the agent has or has not sufficient funds of the non-resident in his hands.

Question 52.—What modification would you suggest in the definition of "agricultural income" Section 2(1) to avoid the contingency of the same income being taxed by the Central Government as well as the State Government, e.g., in respect of income from forests, dividends from agricultural companies, etc.?

This Chamber recommends that the taxation of agricultural income be made a Central Government subject.

Question 53.—Are you in favour of integrating agricultural income with non-agricultural income for rate purposes? If so, which of the following methods would you advocate :

- (i) Aggregation of agricultural and non-agricultural incomes only under the State Acts ;
- (ii) Aggregation of agricultural and non-agricultural incomes only under the Central Act ;
- (iii) Aggregation of agricultural and non-agricultural incomes both under the State and the Central Acts ?

Please discuss the administrative, constitutional and other problems that are likely to arise if any of the above alternatives is adopted.

If the recommendation given in the reply to Question 52 is adopted then this Chamber considers that agricultural income should be aggregated with non-agricultural income only under a Central Act.

Question 54.—Would you recommend the abolition, by a suitable amendment of the Constitution, of the distinction between agricultural and non-agricultural incomes and the taxation of both types of income, aggregately under a Central Act?

Yes.

Question 55.—Is the treatment given to irregular and fluctuating income in the present law satisfactory? In particular, should any changes be introduced—

- (i) to average income over a number of years where receipts are irregular and fluctuating ;
- (ii) to spread lump sum receipts over a number of years ?

It is considered that the existing treatment of irregular and fluctuating income in the present state of the Law is not satisfactory because of the high incidence of Super Tax in peak years in the case of such persons as authors, playwrights, professional men whose accounts are maintained on a cash basis, stock brokers, agriculturists, etc. and recommended (i) that where receipts are irregular and fluctuating, the income should be averaged over a number of years (ii) Lump sum receipts should not be regarded as taxable income but if there are any cases where they can properly be so treated, they should be spread over the number of years to which the receipt relates.

Exemptions

Question 56.—Do you think the present provisions regarding exemption of charitable and religious trusts need any modification? If so, in what respects?

It is considered that the present provisions regarding exemption of charitable and religious trusts are adequate.

Question 57.—(i) Should the business profits of co-operative enterprises, which are now exempt, be charged to income-tax and super-tax? If so, should co-operative societies be treated as companies or should a lighter levy be imposed? In case the exemption is continued, should it be restricted to certain categories of co-operative enterprises?

(ii) Do you agree with the view that the income derived by co-operative housing societies by way of rent should not be treated as income from property assessable to income-tax? Would you, in this respect, differentiate between tenant co-partnership housing societies and other types of housing societies?

(iii) It has been suggested that there are divergent decisions by different Income-tax authorities in respect of assessment of income of co-operative societies from sources other than business. If this is so, please indicate such decisions and the measures you would suggest to secure uniformity in assessment.

(i) It is considered that undistributed profits of co-operative enterprises should be taxed in the same way as those of any ordinary association. In this connection no attempt should be made to apply provisions of Section 23A to Co-operative enterprises.

(ii) No comment.

(iii) No comment.

Question 58.—Are you in favour of continuing the concessions given to new industrial undertakings under section 15C of the Income-tax Act? Have initial and extra depreciation allowances made the concessions practically infructuous? If so, what are the directions in which the provisions of this section should be modified?

It is considered that the concessions given under the provisions of Section 15C are so hedged in with restrictions that no hardship would be caused by the withdrawal of the Section, particularly having regard to the present rates of initial and extra allowances for depreciation.

Question 59.—A suggestion has been made that banking profits of foreign branches of Indian banks should be given concessional treatment for tax purposes in order to encourage the opening of branches abroad. What are your views?

To encourage the opening of foreign Branches by Indian banks, it is recommended that profits earned abroad by such Branches should not suffer Income-Tax at higher rate than they would if the profits had arisen in India and consequently if the rate payable in the foreign country in which the profits are earned exceeds the Indian rate, the difference should be adjusted against the tax payable on the income earned in India.

Question 60.—Should any liberalisation be made in the present limits of exemption from tax of life insurance premia and contributions to provident funds?

It is considered that liberalisation of the present limits of exemption from tax of life insurance premia and contributions to Provident Funds is most necessary and very much overdue because the present exemption limit was fixed many years ago and is now completely out of relation to the present economic conditions. Whilst the basis of exemption of one-sixth of the total income is considered fair, it is recommended that the present limit of Rs. 6,000 for an individual and Rs. 12,000 for a Hindu Undivided Family shall be doubled.

Allowances

Question 61.—(i) Do you favour the grant of larger depreciation allowances to assist industry to finance the considerably increased costs of replacement of

assets? If so, how and in what form should they be given—

- (a) by larger depreciation allowances on new assets;
- (b) by revalorisation of existing assets;
- (c) by treating the excess of replacement cost over original cost as revenue expenditure;
- (d) by any other method?

(ii) What is the justification for assistance from public resources to certain classes of taxpayers only by way of covering partially the excess of replacement cost over original cost of old assets?

(iii) In case adequate justification exists for assistance by Government in the form of tax concessions to meet the situation, what safeguards should be prescribed to see that the funds so made available are utilised for the purposes for which they are intended?

i) The problem of finding additional funds with which to finance the extra cost of replacement of fixed assets which has resulted from the inflation in monetary values caused by the Second World War applies in the case of the replacement of fixed assets which were originally installed before 1st September 1939.

In respect of fixed assets which have been installed on or after 1st April 1948, the various special rates of depreciation which are now allowed for Income Tax purposes are adequate and, on the assumption that they will be continued, at any rate for some years to come, it can be said broadly that the full value of a post-war installed fixed asset will have been depreciated for income-tax purposes within its working life and thus, in respect of such post-war installed fixed assets, funds, if permitted, for income-tax purposes, to be retained for the business with which to effect their replacement at the end of their working life.

These special rates of depreciation allowances do not unfortunately, apply to fixed assets which have been installed prior to the War and it is in respect of those assets that the cost of replacement presents so much difficulty to business in finding the necessary funds to meet the very heavy extra cost of something like three times their original cost. In the view of this Chamber, one of the methods suggested under (a), (b) or (c) of paragraph (i) will meet the case of dealing with the replacement cost of pre-war installed assets and it is considered that the problem can only be dealt with by allowing special rates of depreciation for the next few years on assets which were installed prior to 1st September 1939 and which are still in use or alternatively businesses should be permitted to build up over the next few years a special replacement reserve equal, at least, to twice the original cost of such assets.

(ii) If something on the lines of the recommendation set out above could be accepted, the suggested assistance would be applicable to all classes of taxpayers whose businesses are employing fixed assets installed prior to the War and the objection that the additional allowance would only be applicable to certain classes of taxpayers would, it is considered, not be valid because those taxpayers who have set up business since the War are entitled to the extra depreciation allowance applicable to post-war acquired fixed assets.

(iii) If the suggested special reserve for replacement of pre-war acquired fixed assets is acceptable, it is considered that safeguards are necessary to ensure that the reserve is used for the purpose for which it is intended and should a worn out pre-war acquired fixed asset not be replaced within three years, the amount of the special reserves already allowed as an expense for income-tax purposes should then be disallowed and added to the taxable income.

Question 62.—Are any changes called for in the classification of assets for purposes of depreciation, rates of depreciation and methods of computing the allowances?

The present classification of assets for the purposes of depreciation is not unreasonable and whilst we disagree with the basis of calculation of the allowances, in the answer to the preceding question, the rates themselves in relation to the present basis, are not unreasonable except that it is considered that many of the smaller assets, e.g., furniture, tools in use, electrical fittings, bicycles, books, etc., should be treated on the basis of replacement and not of writing them off by means of a depreciation allowance.

Question 63.—Should any tax concessions be given to encourage development of mineral resources? If so, what form should they take? In particular, should depletion allowance on wasting assets be allowed? How should it be computed for different kinds of assets you have in view?

It is considered that mining concerns should be treated for taxation as they are in South Africa where development expenditure, whether on capital account or otherwise, is allowed as a charge before arriving at profits assessable to tax.

Question 64.—In what form would you provide for personal and family allowances—

- (i) exempting the first slice of income from tax; or
- (ii) providing specific allowances for family and dependents?

In the case of (i), do you consider that the first slice—Rs. 1-1,500—should be revised? In the case of (ii), what treatment would you give to the Hindu undivided family?

It is recommended that the first slice of income up to a reasonable limit should be completely exempt, such slice being double that of an individual for a Hindu Undivided Family.

In addition, there should be reasonable allowances in respect of married persons and children.

Question 65.—Should the present law regarding admissible expenses (section 10(2)) be altered? If so, please indicate, with reasons, the items of expenses (i) which are not now admissible but, in your view, should be admissible and (ii) which are now admissible but, in your view, should not be admissible.

It is recommended that the words inserted into Section 10(2) (xv) by the Income-tax (Amendment) Act, 1952, "not being an allowance of the nature described in any of the Clauses (i) to (xiv) inclusive and" be deleted.

It is further recommended that the transfer of the employers' contribution and interest thereon in an unrecognised Provident Fund to the new Government Provident Fund Scheme should be allowed as a business expense.

Rate of Structure

Question 66.—(a) Are you in favour of combining income-tax and super-tax into a consolidated levy?

(b) What are the merits or demerits of such a step from the point of view of (i) assesses (ii) administration?

(c) Are you satisfied with the degree of progression in the present rate structure (both income-tax and super-tax) especially in regard to its economic effects?

(d) In case you consider a change is necessary, what alternative rate structure would you recommend?

(e) Should the rate of surcharge levied under Article 271 of the Constitution also be graduated?

(a) It is considered that Income-tax and Super-tax should be combined into a consolidated levy.

(b) Provided the consolidated tax is properly graduated there should be no demerits from the point of view of the assessee and the present anomaly whereby no relief is obtainable by an assessee for Super-Tax (Corporation Tax) already paid by a Company in respect of income derived therefrom, whereas relief is granted for Income-Tax paid by a Company, will disappear.

No administrative disadvantages are apparent and it is considered that in fact a consolidated levy will simplify procedure because only one computation of the tax payable will be necessary.

(c) It is considered that the present rate structure of both Income-tax and Super-tax is too severe in its effect on the middle income levels.

(d) The following rate structure is recommended:—

Suggested Rates of Income-tax

Individuals, Associations of Persons & Unregistered Firms:

On the first	Rs. 4,200/-	Nil
On the next	Rs. 5,800/-	1 anna
"	Rs. 5,000/-	2 annas
"	Rs. 5,000/-	3 annas
"	Rs. 5,000/-	4 annas
"	Rs. 5,000/-	5 annas
"	Rs. 10,000/-	6 annas
"	Rs. 15,000/-	6 annas 6 pies
"	Rs. 15,000/-	7 annas
"	Rs. 30,000/-	8 annas
"	Rs. 1,00,000/-	9 annas
"	Rs. 1,00,000/-	10 annas 6 pies
Balance		12 annas

Hindu Undivided Family:

First Rs. 10,000/- nil and thereafter as for Individuals.

Companies:

7 annas in the rupee, with a rebate of 3 annas on undistributed profits ploughed back.

(e) It is considered that the principle of allowing for the receipt of a Surcharge in the annual budget is wrong and the powers given under Article 271 of the Constitution for imposing a Surcharge should only be used in instances of grave national emergency.

Question 67.—Have you any change to suggest in the exemption limit for individuals (Rs. 4,200) and for Hindu undivided families (Rs. 8,400)?

It is considered that present exemption limits are reasonable provided that the exemption is made applicable to all tax-payers, *vide* our answer to Question 64.

Differentiation.

Question 68.—(a) Are you in favour of a distinction being made between earned and unearned incomes? What is the economic justification for such a distinction?

(b) Is the present definition of "earned income" in section 2(6AA) of the Income-tax Act adequate in this respect or would you suggest any modification?

(c) Should the quantum of relief now afforded be extended or reduced? If so, to what extent?

(a) It is considered that the distinction between earned and unearned incomes is only necessary for the purpose of granting an earned income allowance and, provided the principle of a single graduated tax is accepted and allowances for married persons and children, *vide* our reply to Question 64, are introduced, the present level of earned income allowance is considered adequate.

(b) It is considered that the present definition of "earned income" in Section 2(6AA) is adequate.

(c) See answer to (a) above.

Miscellaneous.

Question 69.—Have you any changes to suggest regarding the principles followed in valuing stocks of a business for assessment purposes?

The principle which should be followed in the valuation of stocks, is that universally recognised of cost or market value, whichever is the lower, provided it is clearly understood that market value must take into account any reduction in value which has occurred subsequent to the close of the financial year up to the date when the accounts are finally closed.

Question 70.—Do you consider that any change is called for in the method of assessment of the Hindu undivided family? If so, in what respects?

No comment.

Question 71.—Should exemption from income-tax be allowed in respect of voluntary surrender by managing agents of the whole or a part of managing agency commission? What safeguards should be laid down against misuse of such a provision?

It is considered that exemption from Income-Tax should be allowed in respect of voluntary surrender by Managing Agents of the whole or a part of their Managing Agency Commission unless it can be shown that the surrender has been made *vide* with the intention of evading payment of tax.

Question 72.—On what basis would you suggest that double income-tax avoidance agreements should be concluded between India and other countries?

It is considered that the only tax which should be payable is that of the country in which the income arises and in no circumstances should income be subjected to double tax.

Question 73.—Is the present law relating to determination of "bona fide annual value" of property and deductions allowed from it satisfactory? If not, please give any alternative proposals you have in this respect.

It is considered that the present provisions of Section 9 of the Income-tax Act are adequate.

Question 74.—Is any change required in respect of provisions relating to carry-forward of losses? Are you in favour of allowing losses to be carried backward in case of cessation of business?

It is considered that losses should be carried forward without any time limit in the same way as unabsorbed depreciation.

On discontinuance it should be provided that the last three years of assessment may be adjusted, at the option of the assessee, to the actual results of each of those three years and any tax found as the result, to have been over-paid, should be refunded.

Question 75.—Do the provisions relating to the payment of advance tax under section 18A of the Income-Tax Act need any modification?

It is considered that no revision is necessary to the existing provisions of Section 18A.

Question 76.—Do the principles underlying the assessment under section 34 of the Income-tax Act need any modification?

Section 34 of the Income-Tax Act in its present form was the result of the amendment made in 1948 to the original section when it was considered necessary to provide Income-Tax Officers with wide and sweeping powers to tackle cases of tax evasion. The limit of eight years introduced in the section was mainly in-

tended to cover all cases to be investigated by the Income Tax Investigation Commission, so that there could be no loss of revenue by assessee's pleading limitation. Now that the Income Tax Investigation Commission has nearly completed its labours and evaded incomes have been brought to light presumably to the fullest extent possible, it is no longer considered necessary to retain the present Section 34 in the Act.

It is therefore suggested that a return should be made to the old Section 34 i.e., before its amendment in 1948, the language of which section was quite fair to both the assessee's and the Income Tax Officer's point of view. Under the present Section 34, it is impossible for an assessee to be certain of his Income Tax liability until eight years have expired after the particular year of assessment.

Question 77.—What measures would you suggest for simplifying the procedure of assessment in order to reduce the cost of compliance with the regulations?

It is considered that Income Tax Officers should place more reliance than they appear to do so on present on audited accounts and computations prepared by qualified representatives of assessee's. They should devote less time to detailed checking of returns submitted on behalf of assessee's by qualified representatives which will allow greater care to be paid to matters of principle and to returns of assessee's not prepared by qualified persons.

Question 78.—It has been suggested that the Appellate Tribunal should have powers to enhance assessments in the same manner as Appellate Assistant Commissioners have. What is your opinion?

It is considered that the Appellate Tribunal should continue to be a judicial body without powers of enhancement.

Taxation of Companies and Shareholders.

Question 79.—Do you recommend that an element of progression should be introduced in the corporate tax?

Please see answer to Question 66 wherein it will be noted that it is recommended that the tax applicable to all Companies should be at the flat rate of seven annas in the rupee with a rebate of three annas on as much of the profit as is undistributed and ploughed back.

Question 80.—Would you advocate different rates for different types of corporate enterprises, e.g.,

(i) small industries;

(ii) cottage industries;

(iii) private limited companies or what may be termed proprietary companies;

(iv) holding companies?

It is considered that where concessions are necessary in order to assist (i) Small Industries, Cottage Industries, these should be made in the form of suitable subsidies. Differentiation in rates of Income Tax applicable to such concerns is not considered a suitable method of affording them financial assistance.

In regard to (iii) Private Limited Companies and (iv) Holding Companies, if our recommendation for a flat rate of tax to be applicable to all Companies is adopted, such Companies will not require any further relief because any income received by them in the form of dividends from shares in other Companies will automatically qualify for relief on account of tax paid by the Companies from which the dividends are derived and will not be subject to tax a second time.

Question 81.—There is a demand for the exemption of inter-corporate dividends from corporation tax. Do you consider this justified, and if so, why?

It is considered that the demand for the exemption from Corporation Tax of inter-corporate dividends is fully justified because the present system results in the same income being taxed twice over. As explained in the answer to the preceding question, a single rate of tax applicable to all Companies will meet the case.

Question 82.—Do you think that any special provisions are necessary for the assessment of—

(a) banks; and

(b) investment companies?

Do existing rules relating to assessment of insurance companies, especially mutual insurance associations, require any change? If so, in what respect?

(a) It is not considered that any special provisions are necessary for the assessment of Banks, subject to our answer to Question 59 above concerning foreign Branches of Banks.

(b) Provided the present Super Tax (Corporate Tax) applicable to companies is abolished and Company profits are subject to a single flat rate of tax, no special provisions are considered necessary for the assessment of investment Companies.

As regards Insurance Companies, we have no information on which to base any comment.

Question 83.—Do you think that differentiation should be made between distributed and undistributed profits of companies for tax purposes? If so, on what grounds? What change would you suggest in the present quantum of differentiation in favour of undistributed profits? Should the concession in future be restricted to particular industries?

the tax concession in favour of undistributed profits is allowed to continue as at present or in a modified form, what measures would you suggest to ensure:

(a) that retained profits are not used as a device by share-holders of private limited companies to evade super-tax;

(b) that retained profits are actually applied for productive purposes?

particular, are the provisions of Section 23A of the Income-tax Act satisfactory? If not, what changes would you suggest?

In this Chamber's remarks on paragraph 61, the necessity for increasing the rebate of tax on undistributed profits in order to provide for replacement of sets has been stressed and in the suggested rate of 3 annas applicable to Companies, shown in our comments paragraph 66(d), a rebate on undistributed profits 3 annas in the rupee has been suggested.

It is considered that the foregoing comments apply usually to private manufacturing and trading Companies to public Companies and it is the opinion of this Chamber that such private Companies should be excluded from the operation of Section 23A.

This would thus leave Section 23A applicable only to the private investment Company and in respect of such Companies it is considered that no rebate should apply to that part of their profits which are retained in the business.

It is further considered that the present percentages to which profits may be retained are reasonable and do not require amendment provided that the Section is so amended as to allow the Income Tax Officer discretion to take other factors into account besides those presently permitted which are limited to the smallness of profits made and any past losses. Such other factors could include the cash position of the company and any losses incurred subsequent to the accounting period under assessment.

Question 84.—Do you think, in view of the fact that profits distributed by a company are subjected to corporation tax, it is appropriate that they should also be charged to super-tax in the hands of share-holders? If not, what are your suggestions in this regard?

We have recommended (a) a single consolidated levy of tax and (b) a flat rate of tax applicable to the profits of all Companies. If these recommendations are accepted it follows that income derived from a company, which will have already suffered tax at the Company rate, will either have to be subjected to additional tax in the hands of the shareholder, representing the difference between the Company rate of tax and the rate applicable to that slab of the shareholder's income into which the dividend falls or, conversely, the shareholder will be entitled to a refund of the difference between the Company rate of tax and the rate of tax applicable to him, should his income be below the slab at which the rate of tax payable will correspond with the rate applicable to Companies.

Question 85.—Would you consider that industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies should be required to contribute, from their earnings in the way of income-tax or in other ways, to general revenues?

It is considered that industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies should pay Income Tax in exactly the same way as is paid by ordinary industrial concerns. If the profits of State enterprises are not subject to the same taxes as those of private concerns, the latter are put to a grave disadvantage and, secondly, unless the profits of State-owned concerns are subject to the same taxes, it is very difficult to measure their standard of efficiency compared with that of private industry.

Evasion and Avoidance of Tax

Question 86.—What measures would you suggest for the greater use of the services of Chartered Accountants for assisting in the determination of the taxable income of assessee? What obligations should be placed on a Chartered Accountant when he certifies a statement of accounts of an assessee for purposes of income-tax assessment? In particular, with a view to minimising evasion of tax, would you recommend that the certificate of a Chartered

Accountant should invariably accompany the return for business income over a certain limit? If so, would you suggest that a form of certificate should be prescribed indicating the scope of the check that should be exercised by Chartered Accountants who render the certificate mentioned above. Do you agree that fees payable by assessee to Chartered Accountants for such certificates should be restricted to a schedule to be prescribed by Government?

The Institute of Chartered Accountants in India is a recognised professional body with adequate powers of control over its members so as to ensure a proper standard of integrity. Therefore it is considered that accounts and computations of assessee prepared by members of that Institute should be accepted as far as possible with the minimum of detailed enquiry.

It is considered that assessee ought not to be compelled to utilise the services of a Chartered Accountant and the Income-tax Officer should limit himself to advising an assessee to doing so. No standard form of certificate is considered practicable or desirable and it must be left to individual members of the profession to decide on the form of certificate which is properly applicable in each case. Similarly, no standard scale of fees is considered practicable or desirable.

Question 87.—What changes would you suggest in the present law relating to the representation of assessee before Income-tax authorities (section 61) in order to ensure—

(i) effective representation of assessee at reasonable fees;

(ii) a minimum level of proficiency on the part of representatives regarding the subject of income-tax law, rules and regulations?

It is considered that no change in the present Section 61 of the Act is necessary.

Question 88.—Will it assist in checking evasion if the names of the persons who are penalised for concealment of income are published?

It is considered that the names of persons penalised for concealment of income should only be published where criminal proceedings are taken and the persons concerned are found guilty.

Question 89.—Do you think that the present practice of excluding, from taxable profits, perquisites given to employees of business undertakings results in considerable loss of revenue? If so, please state the perquisites you have in mind, and how they should be dealt with for the purposes of taxation.

It is considered that the exclusion from taxable profits of perquisites given to employees of business undertakings does not result in any considerable loss of revenue and it will no doubt be appreciated that by far the greatest proportion of such perquisites are in fact expenses properly and necessarily incurred for the purpose of the business.

In this connection attention is drawn to paragraphs 140 and 188 of the report of the Income Tax Investigation Commission, 1949.

Question 90.—In the case of a company under liquidation, what steps, if any, would you suggest for safeguarding payment of tax dues before any payments are made to shareholders?

It is considered that Section 18A, if properly enforced, gives sufficient safeguard for the payment of tax dues in the case of a Company which subsequently goes into liquidation.

Question 91.—Do you think that, in order to minimise evasion and avoidance of tax, there is a case for conferring larger powers on income-tax authorities? If so, what further powers should be given to them? In particular, should powers to search premises and seize documents and books of accounts be given to Income-Tax Authorities? If so, what is the lowest grade of officer on whom you would confer these powers?

It will be recollected that Clause 38 of the Income-tax Amendment Bill, 1951 proposed to introduce very wide powers, amongst others giving any Income Tax Authority the right to impound and retain in its custody any books of account or other documents produced before it and it was further proposed to introduce into the Income-tax Act a new Section 37A giving power of entry.

These proposals met with almost universal condemnation at the time of the introduction of the Bill and were subsequently dropped.

The comments of this Chamber on the particular Clause were as follows:

"The proposal that any Income-tax Authority may impound and retain in its custody, for such period as it thinks fit, any books of account or other documents produced before it in any proceeding under this Act will, it is considered, lead to hardship in many cases. It is therefore suggested that

the sub-section should be amended to read as follows:—

'Any Income-tax Authority not below the rank of Inspecting Assistant Commissioner may order the impounding and retention for a reasonable period, of any books of account or other documents produced in any proceeding under this Act, provided that the assessee shall be allowed reasonable access to the books or documents and to make extracts therefrom.'

As regards the proposed new Section 37A, this Chamber considers the proposals wholly objectionable as they infringe on the liberty of the subject. If an Income-Tax Authority desires to enter and search, the tax-payer must be given the same rights as he has under the Common Law and the Income-Tax Authority must obtain a search warrant by application to a First Class Magistrate."

The views of this Chamber in this regard remain unchanged and have been met to some extent by Sub-Section 2 of Section 37 that books and documents may not be retained for longer than 15 days without authority from the Commissioner.

Question 92.—*What precautions are necessary and possible to prevent the creation of an artificial legal entity—a trust or a private limited company or a partnership, especially family partnership—either for avoiding payment of income-tax or for fractioning of income to escape higher rates? Would you recommend the use of penalty rates of tax to minimise such practices?*

This Chamber is of the view that the taxpayer is fully entitled to reduce his tax liability by any legal method of which he is able to avail himself and the suggestion that penalty rates of tax should be imposed in cases of persons who have by legal methods been successful in reducing their tax liabilities is not only wholly objectionable but legally indefensible.

As regards illegal evasion of tax, it is considered that the present penal provisions contained in the Act are adequate.

Recovery

Question 93.—*In the case of a registered firm, would you advocate recovery of unrealised tax of any partner from the firm as such or from other partners?*

The point raised in this question appears to be covered by the provisions of the Indian Partnership Act 1932.

Question 94.—*Are present arrangements relating to recovery of income-tax adequate? Would you advocate the Income-tax Department having a separate machinery for enforcing the recovery of arrears of tax?*

It is considered that the present provisions of the Income-Tax Act regarding recovery are adequate, provided they are properly administered.

Question 95.—*What provisions should be made to ensure timely collection of tax from private limited companies? Do you consider that liability for payment of tax in such cases should be placed upon shareholders of the company in proportion to their share-holdings?*

It is considered that under the present provisions of the Income-Tax Act for advance payments of tax, if properly applied, and provided that the machinery of assessment is not unduly delayed, there should be adequate protection secured to the Revenue against losses of the nature envisaged by the question. The fact that there may be a few cases of the Revenue being defrauded through the means of a Private Limited Company, should not be permitted to destroy the principle of limited liability.

Question 96.—*If income from any property is included for assessment purposes in the hands of a person other than the ostensible owner, would you agree to the tax so assessed being also made recoverable from such property?*

If the transfer of the property is proved to have been made with the intent of illegal evasion, it is agreed that in such cases tax correctly assessed on the income arising from the property should be made recoverable from the property itself.

GENERAL

Question 97.—*What concrete measures should be taken to improve the relations of the Income-tax Department with assessees, especially in regard to—*

- (i) provision of free advice to small assessees on the following points:
 - (a) maintenance of accounts in a form acceptable to the Income-Tax Department; and
 - (b) matters such as filling returns of income, claiming refunds, facilities for tax payment, expeditious disposal of assessments, etc.;

- (ii) provision of information on various matters relating to assessment proceedings, such as disposal of refund applications, adjournment applications, examination of records, etc.
- (iii) arrangement of work so as to obviate necessity of assessees or their representatives having to wait in Income-tax Offices unduly long periods; and
- (iv) securing of the largest measure of agreement on facts between the assessee and the department at Income-Tax Officer level?

In the opinion of this Chamber the relations between the Income-Tax Department and the public, particularly small assessees, will only improve with Income-Tax Officers and their staffs learn to look at themselves as public servants with one duty only—assess the taxpayer fairly and correctly within provisions of the Law and in so doing, to elicit from the assessee all the facts concerning his case, both of which benefit the taxpayer as well as those which are to the Department's favour.

In order to improve relationships between the taxpayer and the Department, we advocate the establishment of a Public Relations Section within the Department, with a Public Relations Officer attached to the Assistant Commissioner.

Such P. R. Os would have nothing to do with assessments or investigation proceedings and their duty would be to help the taxpayer over such matters those raised in this question.

Question 98.—*What changes would you suggest in existing arrangements relating to:*

- (i) issue of notices;
- (ii) simplification and filing of returns,
- (iii) levy of penalties;
- (iv) recovery of tax; and
- (v) appellate procedure and machinery, particularly with reference to administrative control of Appellate Assistant Commissioners?

No comment on points (i) to (iv) as these have already been dealt with in replies to previous questions.

(v) As regards appellate procedure and machinery this Chamber considers that the Appellate Assistant Commissioner, who is at present subordinate to the Central Board of Revenue, should, as an Appellate Tribunal—be directly under the Legal Department of the Central Government.

Question 99.—(a) *Do you think that undue delay occurs at present in the course of assessment proceedings? If so, what do you attribute this to and what are your suggestions for remedying this?*

- (b) *in order that delays of the kind mentioned above do not appreciably affect collection of a substantial portion of the tax due, should any special concessions be provided to assessees to induce them to make advance payment of tax?*

(a) It is considered that there is at present undue delay in completing assessment proceedings mainly due to the experience of this Chamber, to

- (i) lack of properly trained clerical staff;
- (ii) apparent inability of Income Tax Officers to reach decisions without constant reference to the Assistant Commissioner.

(b) In the opinion of this Chamber, any proposal to encourage the making of advance payments of tax will only result in defeating the object of reducing present delays in finalising assessments, since the fact that tax is collected in advance is one of the factors which lead to delay in completing assessments. If the tax were payable in advance, the assessment would have to be completed much more quickly in order to obtain collection.

In the opinion of this Chamber the solution to the problem must be in

- (i) improvement in the efficiency of the Department
- (ii) insistence on Income Tax Officers taking responsibility to complete assessments.

Special Business Taxes

Question 100.—*What, in your opinion, would be the circumstances, which would justify the levy of Excess Profits Tax or special business taxes?*

In the opinion of this Chamber the levy of Excess Profits Tax or special business taxes can only be justified in case of grave national emergency.

Death Duties

Question 101.—*What are your main reactions to the Estate Duty Bill at present before Parliament?*

This Chamber does not wish to comment on the principle underlying the levy of an Estate Duty or whether the imposition of this tax is justified at this stage of the Country's economic development but the Chamber wishes to say that, in its opinion, Estate Duty, being a tax on capital, should only be used for

the purposes of capital development envisaged under the Five-Year Plan.

It is, in the opinion of this Chamber, wrong that a tax on capital should be utilised for general revenue purposes.

This Chamber hopes that, before the levy of an Estate Duty is actually introduced into operation, adequately trained staff to administer the Act will be placed in position.

Finally, this Chamber hopes that every effort will be made to ensure that adequate arrangements will be made for reciprocal relief with other countries where payment of Estate Duty is involved in more than one country.

Question 102.—Would you in the matter of rates of levy differentiate between self-acquired property forming the estate of a deceased and property inherited by him?

In the opinion of this Chamber there is no necessity to provide for different rates of Estate Duty as between self-acquired property and inherited property.

PART III.—COMMODITY TAXES (Central and State)

CUSTOMS

Import Duties.

Question 103.—Do you think that any changes are necessary in the Indian Customs Tariff in respect of—

- (i) grouping of commodities;
- (ii) additions to and alterations in tariff items;
- (iii) correlation with the Import Trade Control Schedule;
- (iv) clarification in nomenclature and in units of measurement or weight?

(i) Grouping of commodities:

No wide general changes are required in the Customs Tariff Schedules and any such changes would be liable to cause confusion. It is, however, suggested that the anomalies which come to light from time to time should be referred immediately to a Central Authority by the Collector of Customs concerned and that this Authority should decide how an item should be classified in future and advise the public and all ports immediately.

(ii) Additions to and alterations in tariff items. No changes are necessary.

(iii) Correlation with the Import Trade Control Schedule.

It is understood that the Central Government are at present working on this particular question of correlation.

(iv) Clarification in nomenclature and in units of measurement or weight.

Please see the answer to (i) above.

Question 104.—(i) What considerations should govern the fixation of rates of import duties for different groups or sub-groups of commodities or for special tariff items?

(ii) Have you any modifications to propose in the present rates of duties in the light of the considerations suggested by you?

(iii) Do you consider that import duties should be reduced in respect of any specific commodities in order to reduce the scope for smuggling?

(iv) Are there any cases within your knowledge where duties on the constituent parts are higher than on the finished product? Is there adequate justification, in your opinion, for this differentiation?

(v) Do you think that owing to high rates of duties the yield on any commodity has reached the point of diminishing returns?

(i) All raw materials required by indigenous industries should be allowed in at nominal rates and the same consideration should be applied to materials required for agricultural developments which are necessary for the common welfare of the country.

(ii) to (iv)—No comments.

(v) Yes—since these very greatly enhanced rates of Import Duties introduced in April 1953 there are already indications that demand has fallen, thereby, eventually, leading to diminishing returns.

Question 105.—Is the relative use of ad valorem and specific duties in the Indian Customs Tariff satisfactory? If not, in what respects would you enlarge or restrict the scope of application of either whether used singly or in combination?

Yes, it is satisfactory.

Question 106.—(i) In what circumstances would you consider "tariff values" a satisfactory basis for assessment of import duties? (Section 22 of the Sea Customs Act.)

(ii) Are there any commodities to which you would extend the application of "tariff values"?

(iii) What changes, if any, should be made in the procedure for determining "tariff values"?

(i) Under circumstances in which world prices of the commodities concerned are subject to considerable fluctuations.

(ii) Subject to the above.

(iii) No change is necessary.

Question 107.—(i) What changes in your opinion are necessary in the present provision (Sec. 30 of the Sea Customs Act) regarding the determination of "real value" and why?

(ii) Would you suggest any specific measures to counter the evasion of import duties through deliberate under-valuation?

(iii) Have the methods of valuation in the Sea Customs Act proved satisfactory in relation to trade through the land customs border, especially on the Indo-Pakistan border? If not, have you any specific suggestions to make in this regard?

(i) No change is necessary.

(ii) The Customs authorities have already the necessary powers.

(iii) No comments.

Question 108.—What changes would you suggest in the matter of granting exemptions from, or reductions in, import duties especially in regard to:

- (1) raw materials used for essential industries;
- (2) materials used for scientific research;
- (3) materials imported for charitable and humanitarian purposes;
- (4) materials imported for stimulating desirable activities, such as agricultural development; and
- (5) necessities of life?

(1) to (5)—Reductions or remissions of duty in respect of these five items deserve the Government's sympathetic consideration when revenue permits.

Question 109.—To what extent do you think revenue might be sacrificed in the interests of bilateral or multilateral fiscal arrangements such as G.A.T.T. or the preferences in favour of certain Commonwealth Countries.

This is for the Government to decide.

Question 110.—Under what circumstances should customs duties be used in preference to import quotas as a means of restricting imports?

If the purpose of restricting imports is to protect indigenous industries, then Customs duties should be used. If, however, the purpose is to conserve foreign exchange, then import quotas should be imposed.

Question 111.—In what respects should the present law regarding "drawbacks" and "warehousing" be altered in order to assist the export trade in manufactured goods which involve the use of imported raw materials?

The application of drawback to raw materials imported by industries who subsequently export the finished product should be universal and at the rate of 100 per cent.

Question 112.—Have you any suggestion to make regarding the administration of the Sea and Land Customs Acts, especially in regard to—

- (a) facilities for settlement of disputes arising out of appraisement;
- (b) penalties imposed under the Act and the appellate procedure relating to them?

(a) The routine procedure involved in obtaining refund of duty on goods damaged at the time of discharge from the steamer after the "out of charge" order has been given by the Customs Department is unnecessarily arduous. In a specific case, Bills of Entry were presented on 6th May 1952 and 7th May 1952 respectively and the goods assessed to duty on 7th May 1952 and 8th May 1952. On 19th May 1952 a severe storm arose, as a result of which a considerable portion of the shipment was lost overboard or so damaged as it had to be subsequently destroyed. The claim had first to be submitted to the Assistant Collector of Customs (Appraising) who ruled that as the loss took place after the "out of charge" order was given, it was a trade risk to be borne by the importer. Section 33 of the Sea Customs Act relates to damage before delivery of the Bill of Entry. The claim was therefore rejected. An appeal against this order lay to the Collector of Customs who, however, rejected the appeal on similar grounds. Thereafter an appeal was made to the Central Board of Revenue who referred the matter back to the Collector of Customs for his recommendation. At this stage the Central Board of Revenue might have used its discretionary powers.

It is suggested that this prolonged procedure could be cut down considerably and if that is not possible that

Collectors of Customs should possess powers to settle such claims and that at least direct reference by the Collector or by the Importer to the Central Board of Revenue would have saved considerable time and trouble. It is also considered reasonable that under the circumstances of this case a refund was due to the Importer and it should not be left to depend solely on the discretionary powers of the Board.

(b) The period of three months allowed to both Customs and importers in which to make claims for duty paid short or in excess is too short. Importers not infrequently discover such mistakes in audit and an increase in the time limit for demands by Customs or appeals by importers is desirable. It is suggested that the time limit be increased to 12 months.

EXPORT DUTIES

Question 113.—Under what circumstances, in your opinion, should export duties be imposed?

Export duties could (but whether they should be levied would depend on careful consideration of the particular circumstances) be imposed for the following purposes:—

- (a) The conservation of essential raw materials for current or future use within India.
- (b) Moderating the export of even plentifully available raw materials to countries which could by the use of materials at advantageous prices, deprive India of export trade in finished products made from the relative raw materials.
- (c) As a means of raising Government revenue by the collection of Export duty on agricultural or industrial products for which there is a lasting demand overseas, and considerable profits to those concerned in the export of the products concerned.

Purposes (b) and (c) are already recognised by the present and past practice of Government, but in the view of this Chamber, the practice in these respects should be exercised with the greatest care, as in it the following dangers are inherent:—

- (1) The temporary and even permanent loss or reduction of India's export trade owing to the administration's difficulty in reducing or removing the Export duty quickly enough to suit changing circumstances.
- (2) Arising from (1):—
 - (a) The loss of Foreign Exchange;
 - (b) The accumulation of the products concerned within India resulting in disturbance of internal economy;
 - (c) Increase of unemployment.

Question 114.—What measures would you suggest to achieve greater flexibility in the rates of duties to accord with the changing conditions of export markets?

It is probable that India's export trade has suffered permanent loss owing to the failure to adjust rates of export duty in good time. Government's delay in such matters may have arisen because of the preoccupation of members of Government at high level with other vital matters and due to the need which Government have felt for the careful collection and the examination of evidence in support of the case for adjustment of export duty rates.

This Chamber suggests that with a view to arriving at speedier decisions, on one or other of the existing Advisory Councils there should be adequate representation of the industries which are concerned in any export duties which may be in force. If necessary, a new Advisory Council or sub-council may be created.

Question 115.—Would you suggest that the whole or a part of the receipts from certain export duties should be funded for financing schemes for promoting long range development of the export trade, subject to the obligations under G.A.T.T.?

It is not recommended that the whole or part of receipts from export duties should be funded for the purpose suggested, but as export duties are usually appropriated to general revenue account, any funds which it may be judged can usefully be devoted to the purpose of promoting exports should be provided from general revenue.

Question 116.—Would you in the interests of revenue or from any other point of view, recommend increased participation by the State in import and export trade? If so, what form do you think should such participation take?

This Chamber does not form any point of view at present recommend the increased participation by the State in the import or export trade. These remarks are made with reference to trading as a whole and do not cover the import of food grains, sugar or other essentials of life, to the extent that this may be necessary in the national interest.

CENTRAL EXCISES

Question 117.—Do you regard as satisfactory the present selection of commodities for purposes of levying excise duties? If not, what changes would you suggest and why?

It is understood that the Imperial Tobacco Co. of India Ltd., our principal member in this industry, has submitted its opinions on Questions 117 to 123 direct to the Commission and also supplied information on these questions to the Bengal Chamber of Commerce & Industry. It is considered unnecessary, therefore, for this Chamber to answer these questions.

Salt Duty

Question 124.—Would you recommend the re-imposition of the excise duty on salt? If so, on what conditions?

It is considered that the Salt Tax should be re-imposed. Its removal has sacrificed a very considerable revenue for purely idealistic reasons and the actual burden of the tax on the individual is infinitesimal.

Supplementary Note on Question 124—Salt Duty

"The 10 acre scheme" is a concession granted by Government to manufacture salt freely by whatever process desired by the small scale producers, viz., either by solar evaporation, or by boiling brine or by scraping or excavation and extraction of saline earth, there being no need to obtain a licence for such manufacture and also no need to pay any cess to the Salt Department, the only restriction being that the area under operation held by any individual or group should not be larger than 10 acres. The policy governing this scheme was to increase production of salt in the country by providing sufficient incentive to small producers and was introduced in 1948. This scheme originated from the Gandhi-Irwin Pact of 1931 when salt was permitted to be scraped even from salt swamps and later extended up to a limit of 10 acres.

However, in the actual implementation of this policy the following anomalies and difficulties were met with and the concession was largely abused.

(1) Initially the manufacture of salt could only be done by a person holding a licence granted by Government and under this system there were both large scale manufacturers and a good number of small licencees operating areas even less than one acre. When the 10-acre concession was granted in 1948, the regular licencees were still under the obligation of securing licences while the new manufacturers with less than 10 acres were completely free.

(2) The new manufacturers started 10 acre plots in the name of several members of a family with a view to evade the provisions of Central Excise and Salt Act. Salt traders provided finances to hereditary salt workers to set up 10 acre factories in contiguous areas and secured exclusive rights to buy the entire salt production and evaded payment of salt cess.

(3) The quality of salt considerably deteriorated as it was not feasible to make a high quality in small holdings by solar evaporation.

The technical principles involved in the manufacture of solar salt require large areas to be set apart to ensure efficient operation. The Salt Expert Committee constituted by Government in 1948 have dealt with the subject of economic production of good quality salt by solar evaporation and they recommend an area of 100 acres as an economic unit for salt manufacture. They therefore, suggest that all small holdings now being operated should be consolidated, relaid and brought under technical control in units of 100 acres as a minimum.

The reimposition of Excise Duty provides an additional source of revenue to Government, although it is an extra charge on the consumer. We would welcome this reimposition in as much as Government will be able to enforce with greater effect, all measures required to improve the yield and quality of salt in the factories."

Taxes on the Sale or Purchase of Goods and on Advertisements

Question 125.—Under the Constitution, the only sales or purchases which can be taxed are sales or purchases of goods. Do you consider that the sales tax should be extended to—

- (i) services, so that the tax may be leviable on
 - (a) charges for services proper (e.g., bills from a goldsmith or a printer),
 - (b) charges for both services and goods where the two cannot be readily separated (e.g., hotel bills) and
 - (c) charges for certain types of goods into the price of which service enters as a substantial element (e.g., painting or photographs); and
- (ii) transactions of sale or purchase in stock exchanges and futures markets?

If so, please deal with the administrative and other issues which may arise in the implementation of your suggestions.

(i) (a) No. Such dealers are already liable to Income Tax and Profession Tax. They only "sell" their skill which cannot easily be assessed in terms of money. Experience shows that States fix rates of tax to suit their financial needs. If such services are taxed too highly in one State they will not be able to meet outside competition and will either have to close down or migrate to more favourable areas.

(i) (b) Under Rule 4(3) of the Madras Sales Tax (Turnover and Assessment) Rules provision is made for taxing a portion of such transactions. The rates vary with the nature of the contract and have been worked out after detailed consideration. It is considered that this arrangement is not unreasonable, particularly so as some latitude is allowed to the Madras Board of Revenue to use its discretion in unusual cases. Any attempt to fix more exactly the tax payable on such transactions would, it is considered, involve such an increase in staff as would not justify the results obtained.

(i) (c) Not justified for reasons given under (1)(a).

(ii) Stock Exchange dealings are already subject to Transfer Stamp Duties and therefore it would not be reasonable to attempt to impose Sales Tax on them.

Question 126.—(i) The Union alone has the power to levy a tax on sale of newspapers or on advertisements in them. This power has not, so far, been exercised. Would you propose as desirable and feasible (a) a tax on sales only, or (b) a tax on advertisements only, or (c) a tax on both?

As regards (a), it has been urged that on account of the small price charged for each newspaper, the sales tax would be fractional and cannot be passed on to the buyer, whereas in the aggregate it would be an undue burden on the concern itself. If you agree with this, how would you meet the difficulty?

As regards (b), what classes, if any, of newspapers or advertisements would you exempt from the tax, and what rates of tax, graded or other, would you levy?

(ii) Have you any suggestions to make regarding the taxation of advertisements other than those appearing in newspapers?

(i) (a) For the reasons given it is not, equitable to tax the owner of the newspaper when, unlike other dealers, he cannot pass on the tax to the buyer. This would be unfair discrimination.

(i) (b) Advertisements in newspapers may be either casual or regular but it would be difficult to distinguish between them in practice. The staff necessary to decide between taxable and non-taxable advertisements would not justify the results achieved and the vexation caused.

(i) (c) No tax is recommended.

(ii) A small tax on posters and public trade advertisements appears to be unobjectionable, but separate legislation is necessary and not under the provisions of the Sales Tax Act.

Question 127.—As regards sales tax generally and, in particular, the sales tax on goods leviable by the States, it is sometimes argued that since all goods sold in a State must fall within one of these categories, viz., (a) manufactured or produced within the State, (b) transported into the State from elsewhere in the country and (c) imported into the State from abroad—an extension of increase of excise would serve just as well as sales tax for category (a), of octroi or terminal tax for category (b), and of customs for category (c). Do you agree with this view which implies that the sales tax has no specific function to perform in the country's system of taxation? If not, what in your opinion, from the point of view of a correlated tax-structure, is the legitimate place and scope of the sales tax as distinguished from that of excise, octroi and customs?

This Chamber considers that customs and excise duties have a definite place in the tax structure of any country and are necessary to the national economy, but the levy of local octroi or terminal taxes has no justification whatsoever. They impose medieval restrictions on the free movement of commodities with the attendant evils of inefficiency and corrupt administration. Similarly, Sales Tax has the undoubted effect of restricting business activities and diverting the natural channels of trade and the only possible justification for a Sales Tax is that it is a means of raising substantial revenue for the States. Unless, however, the rates of Sales Tax are kept low they have a regressive effect (for examples of this please see the answer to Question 134 below).

Question 128.—(a) Sales tax is almost invariably levied by the State Governments in terms of the turnover of the dealer over a given period. Since a sales tax leviable on the individual transaction necessitates fairly elaborate accounts, cash memos, etc., which only a small portion of dealers is equipped to maintain, do you agree with the view that, in Indian conditions, the bulk of the sales tax is likely for a long time to come, to continue to be leviable on

aggregate turnover as distinguished from the individual sale-price?

(b) In most States there are separate laws governing sales tax on petrol. To what articles, if any, do you consider it desirable and feasible to extend the particular system adopted in respect of petrol?

(a) This Chamber agrees that it would not be feasible to introduce a sales tax at differing rates on various individual articles, though certain specified articles are subject to a special rate of sales tax in Madras State [see Section 3(2) of the Madras General Sales Tax Act].

(b) State taxation on petrol in Madras State is governed by the Madras Sales of Motor Spirit Taxation Act, 1939. It is a single point tax levied at the point of retail sales. Under this Act the rate of tax for petrol is 6 as. per gallon and for motor spirit other than petrol it is 1 a. 6 ps. per gallon. Kerosene (other than power Kerosene) is now taxed under the Madras General Sales Tax Act. All importers, agents and most dealers are liable for this Sales Tax. This multipoint tax on Kerosene is not only irksome but also has the effect of increasing the consumer price of what is undoubtedly a necessity of life, particularly for poor people. It is considered that either Kerosene should be exempted entirely from Sales Tax or that it should be taxed at one point only.

Question 129.—(1) In regard to a system of levy based on turnover, is the choice broadly limited to the alternatives hereafter mentioned or is there any other system you would advocate? Under the system you recommend would sales tax continue to be roughly as significant a source of State revenue as at present? The alternatives referred to above are:

(i) a relatively low rate of levy at each of almost all points of sale; few dealers excluded and few goods exempted (Multi Point);

(ii) a relatively high rate of levy at only one point, viz., the point at which a registered dealer sells either to a consumer or to an unregistered dealer; exemption from tax of sales by one registered dealer to another registered dealer; exclusion from compulsory registration of a dealer below a certain limit of turnover; a large number of exempted goods (Single Point);

(iii) various combinations of the above.

(2) Which of the above alternatives would you advocate? Please state your reasons in some detail, comparing merits and demerits from the point of view of (a) the consumer, (b) the dealer, (c) industry, trade, etc., generally and (d) Government. Please relate your arguments, as far as possible, to lessons which may be drawn from the actual working of Sales Tax Acts in different States.

(3) In particular:

(i) as regards (a) above, do you think that the sales tax, or any particular form of it, leads to a greater burden being placed on the consumer than is accounted for by the proceeds which accrue to the Exchequer?

(ii) as regards (b) above, have you any suggestions to make regarding the simplification of forms, accounts, etc., and of the procedure generally in order to make the administration of the tax less burdensome to the dealer? Further, having regard to the cost of maintenance of the machinery for compliance, would you suggest an alternative form of taxation so far as small dealers are concerned?

(iii) as regards (c) above, has the imposition of the sales tax led to any noticeable change in the organisation of the trade in the country, especially in regard to the size of the business unit, location of head offices, number of intermediaries, variety of the goods dealt with, etc.?

(iv) as regards (d) above, please examine the financial and administrative aspects, including the scope for evasion presented by the particular system and the difficulty or otherwise of counteracting it.

Since all the Sales Tax Acts in South India provide for the Multi-Point system it is difficult for this Chamber to express an opinion on the rival merits of Single and Multi-Point taxes. It is believed that from the administrative angle (both official and business) there is little difference in practice between the two taxes as each dealer, whether liable to tax or not, has to maintain accounts which the tax authorities must check. The consumer, probably, would prefer the Multi-Point tax, provided its total incidence is not more than a Single-Point tax, because the amount apparently charged to him appears to be smaller than it really is. One cause of vexation should, however, be removed. The State should be prohibited from attempting to assess Sales Tax on sales tax collected by the dealer on the illogical grounds that it forms part of the dealer's turnover.

Question 130.—*In relation to the particular system you advocate :*

- (i) *should there be special rates of levy, higher than the ordinary rate, for certain articles? If so for which types of articles?*
- (ii) *should there be special rates of levy, lower than the ordinary rate, for certain articles? If so, for which types of articles?*
- (iii) *which articles, if any, should be exempted altogether and why? Please elaborate the principles which, in your opinion, should underlie exemptions.*

(i) As observed in commenting on Question 128(a) such differential taxes already exist in Madras State and generally speaking there has been no serious objection to them.

(ii) Under the Madras General Sales Tax Act certain articles are taxed at the point of purchase because they are normally exported. Certain articles (such as Bullion) only require a licence as the profit is very small. Certain articles are only taxed once (e.g., raw cotton, tanned hides, etc.) as the margin of profit is small and it is necessary to keep the incidence of the tax low in order not to interfere with the volume of trade. It is difficult to specify which articles should be taxed lightly since conditions vary from State to State.

(iii) Certain goods, such as the first sale of agricultural produce and sale of handloom goods are already exempted from sales tax in Madras for obvious reasons.

Briefly stated, the reasons for varying the incidence of tax are:—

- (1) the nature of the article—whether luxury or essential;
- (2) the margin of profit obtained on the sale of the article;
- (3) the nature of the trade, e.g., whether export trade or other trade to be particularly encouraged;
- (4) exemption for certain classes of goods, for special reasons, some political and some local.

On the whole, these considerations appear to be reasonable and unobjectionable, provided there are not too many variations or rates of tax on too many varieties of goods.

The articles exempted by the Government of India Notification under Article 286(3) of the Constitution and those listed in the Madras General Sales Tax Act and Rules are recommended for exemption throughout India for the reasons accepted by the Central and Madras Legislatures.

Question 131.—*In regard to system, rates, exemptions, etc., what degree of uniformity between the different States do you consider desirable and feasible? Would you bring it about—*

- (i) *by formal or informal convention;*
- (ii) *by central legislation promoted at the instance of two or more States;*
- (iii) *by constitutional amendment, so as to include certain basic matters connected with the sales tax in the Concurrent List?*
- (iv) *by constitutional amendment so as to include the item of sales tax, as a whole, in the Union List? In the last-mentioned how would you apportion the proceeds? Would this alternative be a practicable proposition from the point of view of the finances of the States?*

It is desirable to have uniformity but some variations are unavoidable in a country so large and diversified. The basic principles should be uniform throughout the country, with uniformity of definitions and in the methods of administration. Either Single-Point or Multi-Point tax should be imposed throughout the country and variations should not be permitted. Certain articles should bear a heavier or lighter rate of tax to suit local conditions and may either be on purchase or on sale, provided legislation is introduced to ensure that no transaction can be taxed twice. If possible it is desirable to have uniform rates of tax on the nonparticularised goods though this may be difficult to impose when the States vary in their financial circumstances. The method by which these results are to be achieved must be decided by the Central Government with the power, if necessary, of compelling non-co-operative States to conform to the general policy.

Question 132.—*To what extent has any desirable uniformity been achieved in regard to exemptions (in favour of "goods essential for the life of the community") under Clause (3) of Article 286 of the Constitution? What principles would you advocate for deciding the exemptions to be made under this provision of the Constitution? Do you consider that the scope of the provision contained in Clause (3) of Article 286 should be extended also to "essential articles" which had been subject to sales tax before the relevant central enactment came into force?*

So far as Madras State is concerned no "desirable uniformity" has been achieved. The list of essential articles detailed in the Notification issued by the Government of India under Article 286(3) of the Constitution, plus, it is considered, firewood and the tools of an artisan's trade, should be exempted from Sales Tax throughout India because these articles constitute the basic and unavoidable necessities of life. The total exemption recommended should be extended to those articles in the list which are now taxed by certain States.

Question 133.—(a) *As regards "sales outside the State", "inter-State commerce", etc., please discuss the adequacy or otherwise of the relevant provisions of Article 286 and suggest remedies for any defects which, in your opinion, have been revealed in the actual working of these provisions.*

- (b) *Please discuss in this connection the desirability and feasibility of the suggestion that purchases only (and not sales) should be taxed, so that the tax jurisdiction of each State might be confined to parties, residing within the State. Alternatively, do you consider that purchases should be taxed in certain cases and sales in certain others; if so, how and on what considerations would you define the two categories? In either case, please describe your scheme in some detail and explain the advantages which you claim for it.*

(a) It is understood that some prominent legislators have said that when they helped to draft and approve Article 286 of the Constitution they intended that transactions involving inter-State and international trade should be exempted from Sales Tax. The Supreme Court in its recent judgment has held that the Article in its present form does not convey that intention and if the Legislature is of opinion that such transactions should not attract Sales Tax, clearly it will be necessary to amend the Article.

If, however, the intention of the Legislature is what the Supreme Court has held the Article to mean, it is considered that further legislation is necessary so as to provide that the taxing authority of one State cannot levy its tax on a seller resident in another State. The reasons for this have been given in detail in the Memorandum submitted by the Federation of Indian Chambers of Commerce to the Government of India. Briefly stated these reasons are:—

- (1) The selling dealer outside the State cannot possibly know all the rates of tax, exemptions, notifications, etc., issued by the 15 States now levying Sales Tax.
- (2) The outside dealer would have to maintain separate accounts for each taxing State within which he transacted business and even then his accounts may be called for by several taxing officers in one State if his transactions overlap several taxation jurisdictions.
- (3) It would be intolerable for a firm with All-India sales to answer the demands, etc., of a host of officials scattered throughout the country.
- (4) The honest dealer would be seriously disadvantaged, as the unscrupulous would take advantage of the administrative and other difficulties in attempting to collect from a seller outside the taxing State and so, by evading the tax, be able to under-quote his more honest competitor.
- (5) Administratively, it would be difficult to collect the tax from a dealer outside the State and the procedure of recovery is laborious prolonged and often infructuous. If the accounts, etc., are maintained in any other language than that known to the taxing officials they would be at the mercy of the unscrupulous.

For these reasons the only practicable solution is that in respect of inter-State transactions the purchaser in the receiving State should bear the tax.

Question 134.—*Do you think that lack of uniformity between the States as regards the rates of sales tax and the methods of applying it (single or multiple point) has the effect of raising barriers in inter-State commerce or of inducing uneconomic diversions of trade? If so, what measures would you suggest to rectify the position?*

Please see answer to Question 127. Where States sales taxes are imposed at differing rates, transshipments are made by dealers from markets with a low tax to rate to markets with a higher tax rate, with the result that the pattern of trade is dislocated and tax evasion is encouraged.

The following are examples of the regressive effect of trade when exorbitantly high rates of Sales Tax are levied. In April 1953 the Madras Government introduced a sliding scale of tax on cigarettes, cigars and tobacco, varying from 10 per cent. to 30 per cent. dependent on the quality of the article, i.e., the more expensive cigarettes, etc., paying the higher rate of tax. For the four months prior to April 1953 the monthly sale of

cigarettes in the State was Rs. 37 lakhs, Rs. 38 lakhs, Rs. 41 lakhs and Rs. 45 lakhs respectively. After introduction of the new rates sales in the next four succeeding months were Rs. 20 lakhs, Rs. 16 lakhs, Rs. 18 lakhs and Rs. 16 lakhs respectively. The enormous loss to the producers, manufacturers and dealers is obvious and entails unemployment and loss of Income-Tax to the Central Government. In November 1952 the Madras Government introduced a Sales Tax of 50 per cent. on the selling price of Wines, Beers and Spirits. The following figures illustrate the effect of this very heavy tax:

	Period 24-5-52 to 23-11-52	Period 24-11-52 to 23-5-53
	Rs.	Rs.
Total value of sales <i>excluding</i> gallage and Sales Tax within Madras State	18,17,224	8,47,655
Central Govt. Customs Duty on above	8,35,417	3,83,546
Gallage fees paid on above	1,21,605	70,603
Sales Tax paid	Nil.	3,88,538

It will be seen that sales dropped 53 per cent. approximately.

Gallage fees are collected for the Madras Government, and these fees with the Sales Tax show a nett gain to the Madras Government of Rs. 3,37,536. Against this, there is a loss to the Central Government by way of import duties of Rs. 4,51,871, which means that so far as overall taxation is concerned the nett loss to India was Rs. 1,14,335. To this should be added the additional loss to the Central Government of Income-Tax from lower profits as a result of sales dropping by 53 per cent. The regressive effect of attempting to levy an exorbitant rate of sales tax is well-illustrated by these examples. The nett tax yield is reduced, profits fall, the consumer is fleeced and unemployment results. The ugly side of the story is the growth of smuggling, corruption and illicit distillation with the added charm of forbidden fruit.

Question 135.—No comments.

GENERAL

Question 136.—Do you think there is a case for vesting in the administration the power to alter, by executive order, the rates of import duties, export duties and excise duties? If so, please indicate in what circumstances and within what limits such power should be exercised.

In the view of this Chamber, there is no case for vesting powers of taxation in the Administration, and the levy of revenue must be the sole prerogative of Parliament.

Question 137.—Do you visualise any scope for extension of the field of commodity taxation as a result of the implementation of the Five-Year Plan?

No comment.

Question 138.—What "luxury" articles, if any, would you suggest on which commodity taxes in any of the various forms might be levied at specially high rates?

In the experience of this Chamber, the present rates of taxes of various kinds, both direct and indirect, on "luxuries", and on many articles which can only be brought within that definition by a considerable stretch of the imagination, are now so heavy as to make the purchase of such articles well-nigh prohibitive to all except persons who have inherited large fortunes.

Certainly, the ordinary businessman, deriving his income from heavily taxed earnings, cannot indulge in the purchase of "luxuries" at their present-day cost.

The disastrous effect of levying prohibitive taxes on tobacco and liquor has been detailed in answer to Question 134. Consumer resistance was immediate and sustained; overall tax revenue fell; the producer, manufacturer and dealer lost heavily, with consequent increased unemployment and consumer resentment.

PART IV.—AGRICULTURAL INCOME-TAX, LAND REVENUE AND IRRIGATION RATES

AGRICULTURAL INCOME-TAX

Question 139.—A few States levy agricultural income-tax but in almost none is it among the more important sources of revenue; the progress of land reforms will further reduce its yield. Would you, in order to increase the yield from this tax or for other reasons (which may please be specified), make major modifications in the present system of taxation of agricultural income? If so, please indicate the modifications you would make.

Question 140.—In particular, do your suggestions involve—

- correlation, and if so, to what extent, of agricultural with non-agricultural income-tax;
- alteration, and if so, in what manner, of the levy of land revenue?

As regards (a), if the correlation suggested takes the form of the levy of a single tax on the total of non-agricultural and agricultural income, instead of the present separate Central and State taxes, please deal with the constitutional, administrative and other problems involved, including the apportioning of proceeds among State Governments. Alternatively, if the State Governments continue separately to levy a tax on agricultural income, but the rates of levy are based on the total of the two types of income, agricultural and non-agricultural, what are the specific problems which arise, and how would you deal with them?

As regards (b), please indicate the probable net effect of the suggested measures on the revenues of Government. What administrative or other issues are involved, and how would you deal with them?

The basis for granting exemption from Indian Income-Tax for Agricultural income was that the lands suffered land revenue. The severity of the charge of the land revenue is however noticed mainly in the case of small land-holders.

On the above reasoning some States have introduced the levy of agricultural Income-Tax but there is complete lack of uniformity either in regard to the levy or in regard to the rates of taxation in the various States. The suggestion is therefore made that Agricultural Income-Tax may be made the subject matter of a central levy for the benefit of the States. Agricultural income may be aggregated with non-agricultural income for the purpose of determining the rate of Income Tax applicable to the non-agricultural income but the agricultural income should be charged at a reduced scale of tax, suggested as follows:—

Incomes under Rs. 6,000	Nil.
Rs. 1 to Rs. 6,000	Nil.
Rs. 6,001 to Rs. 10,000	6 pies in the rupee.
Rs. 10,001 to Rs. 20,000	1 anna 6 pies in the rupee.
Rs. 20,001 to Rs. 30,000	3 annas
Over Rs. 30,000	4 annas

Companies at a flat rate of 4 annas.

Marginal relief to be provided for.

The revenue so collected from Agricultural Income Tax should then be passed on to the State from which the income is derived.

This suggestion involves an amendment to the Constitution but the principle of the suggestion can be supported by the proposal of the Central Government to levy Estate Duty on agricultural property and to pass such Duty on to the States.

It will undoubtedly be necessary to review in certain cases the existing imposts on plantations such as Tea, Coffee, Rubber, etc., so as to prevent the industry being subjected to multiple taxation. Taking the example of Tea, there is (a) land tax, (b) Tea Cess collected on quantity basis, (c) Export Duty at four annas a lb., or an Excise Duty at the rate of three annas per lb., and the suggested Agricultural Income Tax will be a fourth item. It will obviously be necessary to examine the capacity of the industry to bear these various burdens especially bearing in mind the increasing cost of expanding labour legislation.

Question 141.—How would you determine taxable income in the comparative absence of accounts in rural areas? What treatment should, in particular, be given to the following?—

- expenses of cultivation, harvesting, preparation for the market, etc.;
- agricultural losses owing to a calamity or other reasons; (In this connection, would you favour giving the assessee the discretion to choose the alternative of averaging his income over a number of years—say 3 to 5 years—in order to cover good and bad years);
- depreciation in respect of—
 - live stock,
 - implements and carts,
 - means of irrigation, e.g., wells, etc.,
 - buildings?

In the absence of accounts, estimates would have to be made, as are at present made by the Income-Tax Officers in the case of assesseees not maintaining books. Losses should be carried forward for adjustment against subsequent profits. It may be difficult to make assessments on the basis of the average yield per year.

In addition to allowing expenses of cultivation, harvesting and preparation for the market, depreciation should be allowed on implements and carts at 20 per

cent. Live stock may be treated on a replacement basis. The cost of irrigation canals should be allowed to be written off over a period of years. Depreciation should be allowed on Buildings of substantial construction, but Cooly Lines should be dealt with on a replacement basis.

It has come to the notice of this Chamber that attempts have been made by the Income-Tax Officers in North Malabar to levy tax on a portion of the income from coffee, stated to be applicable to manufacturing operations on the analogy of levy of tax on forty per cent. of the profit from tea. This Chamber is strongly of the opinion that no manufacturing operation is involved in the curing of coffee, no mechanical processes are involved and no elaborate machinery is required for curing the coffee beans. This Chamber wishes to emphasise that the curing of coffee is an operation carried out in order to make the produce fit to be taken to the market, and there should be no question of any portion of the profit on coffee being taken as other than agricultural income. The analogy of tea is completely inapplicable to the case of coffee, and it is relevant to point out that the Madras High Court has decided that the curing of green tobacco leaves is only an agricultural operation. (See 1944, I. T. R., page 1.) The recent procedure followed by the Income-Tax Officers appears to be contrary to the observations contained in C. I. T., Madras, vs. Mathias, 1939 I.T.R., page 48.

Question 142.—What rates would you prescribe for agricultural income-tax and how would you graduate them? Is it possible to have uniform rates in all the States? What exemption limits would you lay down?

For suggested rates of Agricultural Income Tax see our answer to Questions 139 and 140 above.

PART V.—OTHER TAXES (Central and State)

Stamp Duties and Court Fees

Question 162.—Under the Constitution—

- (1) the Union is empowered to fix the rates of stamp duties in respect of bills of exchange, cheque, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts, and
- (2) the States are empowered to fix the rates of all other stamp duties.

As regards both (1) and (2), have you any suggestions to make for the levy of a stamp duty where it is not already levied, or for an increase or decrease of the present rates where a stamp duty already exists? Please give reasons for your suggestions. Are there any general principles which you would propose for adoption in regard to the fixation of rates of stamp duties?

As regards (2), since the rates vary from State to State what degree of uniformity do you consider desirable and feasible, and how do you propose to achieve it?

If possible, please estimate the net effect of your proposals on the revenues of States.

Of the various items referred to in sub-section (1) the stamp duty now payable on transfers of shares and debentures varies from State to State as the scale of duty is linked to the scale of duty applicable to conveyances or mortgages. We consider it very necessary that in respect of these items uniformity should be obtained. As the items relate to commercial and business transactions the stamp duty should be kept as low as possible and in any case should not exceed say Rs. 5 per Rs. 1,000.

With reference to sub-paragraph 2 since stamp duties constitute a source of provincial revenue the States would like to have freedom to vary the rate from time to time. In the circumstances therefore although it is desirable it is not feasible to have any uniformity in the scales of duty for transactions other than those referred to in Question 162(1). The recent controversy over having a uniform sales tax bears this out.

We are unable to estimate how the revenues of the State will be affected by the proposals.

Question 163.—Certain States (e.g., Bombay) levy stamp duties on transactions in forward markets. What is your view regarding the complaint that these duties have tended to affect the business in these markets, particularly that of the middle class traders? If you consider that the levy of stamp duty on transactions in these markets is a suitable and potentially important means of securing revenue, what administrative and other measures would you suggest for the efficient collection of such duties? Alternatively, in place of stamp duties, would you suggest some other form of taxation of transactions in stock exchanges and futures markets? If so, please elaborate your suggestion.

We do not consider that stamp duties should be levied on transactions in forward markets. The diffi-

culty is in collecting the stamp duties. There will be considerable evasion as there will be no check over duties not paid. In the circumstances we consider that a mode of taxation for transactions in stock exchanges and futures markets should be adopted. The rate should be as low as possible and on an *ad valorem* basis.

Question 164.—In this country, the stamp duty is ordinarily a tax on documents which constitute evidence of legal rights. There are, however, certain taxes, such as the entertainments tax, which are sometimes collected in the form of stamps, and suggestions have been made that this system may be appropriately extended to the collection of taxes on the sale of goods or on other transactions. Do you agree with this view? If so, to what taxes would you extend the scheme?

We do not agree with the view that taxes on sales of goods or other transactions should be collected in the form of stamps. This procedure will lead to considerable evasion as there will be no machinery for checking transactions which are not duly stamped. In this connection it must be borne in mind that stamp duty is not like Court fees. In the latter the receiving officer sees that the proper Court Fee is paid. In the former case except in the case of registered documents where the registrar checks the stamp duty at the time of registration there is no proper check in the case of documents not requiring to be registered.

As the law stand; at present the only stage at which the stamp duty is checked will be when the documents are sought to be filed in evidence in Court. Government relies upon the penal provisions provided in the Stamp Act but the penal provisions embodied in Section 64 may not in certain circumstances be useful from the Government point of view. The parties may consider it worthwhile to risk non-payment.

Question 165.—What are the more common methods of evasion or avoidance of payment of stamp duty? What means of prevention would you suggest?

The common methods of evasion and avoidance are firstly placing a low valuation on the property. In certain transactions referred to in Articles 23, 31, 54, 55, 58 and 64 of the Indian Stamp Act stamp duty is payable on the value of the property as set forth in the instrument. If therefore a low value is inserted the stamp duty payable will be proportionately low. In our opinion this should be amended so that stamp duty may be collected on the value of the property. The word "as set forth in the instrument" should be deleted.

Another way in which stamp duty is avoided is not to carry out the transaction by means of a document. For instance a seller may receive the purchase price and place the purchaser in possession without executing a document for the purpose. After the lapse of 12 years the purchaser will acquire a good title and Government will then have been deprived of its revenue.

The reason for avoiding the stamp duty is the high rate of duty prescribed by the Act. For instance the rate of duty prescribed on bonds and mortgages is very high when compared with the duties prescribed on similar documents in England and America. This was pointed out in 1925 by the Indian Taxation Enquiry Committee. The high rate of duties also tempt persons to resort to evasion both legal and illegal.

Similarly the stamp duty payable on usufructuary mortgages is far in excess of that payable on simple mortgages. Further in respect of usufructuary mortgages the various Municipal Acts impose surcharge at the rate of 5 per cent. or 4 per cent. and the parties have been at pains to devise methods by which to avoid duties and the legislature has from time to time intervened to prevent the evasion.

Further in charging duties on *ad valorem* scale the points at which the duty increases are separated by wide margins and this work hardship on transactions of a low value. To avoid payment of higher duty parties do split up the transactions and carry them out by more than one document.

Similarly although there is not much difference between a gift and settlement, the former pays a very high duty when compared with the latter and in addition pays a surcharge under certain local municipal laws.

The stamp duty on gifts is at the rate of 3 per cent. in Madras. If however some consideration is set forth in the document then stamp duty is payable only on the value of the consideration. Often times it happens that properties meant as gift are transferred by way of conveyance for a small sum for the purpose of avoiding payment of heavy stamp duty. The only remedy is to decrease the rate of stamp duty payable on conveyances.

Question 166.—The rates of Court Fees differ from State to State. To what extent do you consider uniformity in the rates desirable and feasible?

We do not consider it feasible that Court Fee of a uniform rate should be levied by all States. Court Fee is a State revenue and the State should be at liberty to prescribe the scale as occasion arises.

Question 167.—Have you any suggestions to make regarding the schedules to the Indian Court Fees Act and the rates of levy thereunder?

We consider that the *ad valorem* scale of Court Fee prescribed by the Indian Court Fees Act is very high. In our opinion taking the Madras Scale as the standard it should be reduced by one-half. The fixed duties are not high and may remain as at present.

Taxes on Motor and other Vehicles and Entertainments Tax

Question 168 to 175.—No comments.

Tax on the Consumption or Sale of Electricity

Question 176 to 180.—It is understood that the Federation of Electricity Undertakings of India is replying to these questions.

Betting and Prize Competition Taxes

Question 181.—The betting tax is confined in practice to horse racing. Have you any suggestions to make regarding the rates of betting tax, the manner of levy of the tax, and the measures which may be adopted for minimising evasion of the tax?

(a) In order to spread the incidence of tax evenly throughout the betting community, it is desirable that the tax should be levied on the amount wagered not on the amount won.

(b) It is also desirable that the rate of tax should not exceed one anna in the rupee, i.e., 6½ per cent. and by imposing it upon all stakes wagered this is feasible without diminution in revenue.

(c) By levying the tax on the basis suggested and at a rate not in excess of that suggested, evasion of the tax "on the course" will be automatically minimised if not entirely eliminated.

VIEWS OF THE MADRAS CHAMBER OF COMMERCE, SUPPLEMENTARY TO THEIR REPLIES TO THE TAXATION ENQUIRY COMMISSION.

Copy of letter, dated 30th April 1954 from Secretary of the Chamber to the Secretary, Taxation Enquiry Commission.

During the course of the examination by the Commission on 28th April of the representatives of this Chamber, the question of the treatment for Income-Tax purposes of the additional cost of replacement of assets originally installed pre-September 1939 was discussed and we were asked to consider certain suggestions put forward by the Chairman of the Commission and to submit to you some further notes.

2. As we understand it, the suggestions are:—

(a) That the additional cost of replacement of assets installed pre-War, i.e., the difference between their present replacement cost and their original cost—might be charged against revenue in the year of replacement and the initial depreciation allowance should be foregone and the start of the ordinary depreciation allowance should be deferred for, say, five years.

(b) Alternatively, a Special Replacement Reserve should be allowed to be accumulated for specified industries of national importance.

3. We think the problem of finding finance to meet the extra cost of replacing assets installed pre-War is now universally appreciated and it is generally accepted that the rise in the cost of plant and machinery can be taken at somewhere between 2½ and 3 times the pre-War cost.

It can also, we think, be accepted that the bulk of the industrial equipment now in use in this country was installed pre-War, at some time between 1920 and 1939, so that, allowing, on an average, thirty years useful working life, the bulk of this pre-War installed equipment must, within the next few years, become due for replacement. Much of the equipment may indeed be overdue for replacement either because it has been worked two or more shifts for many years, or because some of it (in the Textile industries for instance) was installed prior to 1920. The problem therefore is becoming immediate but is not one which will continue because the present allowances for Income-Tax purposes on industrial equipment installed since 1948 are adequate to provide for funds being built up to meet its eventual replacement.

4. In our original reply to Question 61 of the Commission's Questionnaire, we put forward two alternative suggestions to meet the problem of replacement of equipment installed prior to 1st September 1939, one suggested special rates of depreciation being allowed for the next few years on such assets and the alternative was that industries should be permitted to build up, over the next few years, a Special Replacement Reserve equal to twice the original cost of such assets, with the safeguard that if a worn out pre-War installed piece of machinery is not replaced within three years of its going out of use, the amount allowed as reserve for its replacement should be taxed.

5. The suggestion made to us, that where a piece of

(d) In order to eliminate illegal betting "of the course" and consequent loss of revenue resulting from such illegal bets, it is suggested that "off the course" betting on horse racing should be legalised and that a limited number of bookmakers should be licenced to receive wagers off the course. This procedure would greatly strengthen Government's hands in dealing with illegal betting in bucket shops.

(e) Collection of tax should be at source. That is to say, Race Club officials should be responsible for the collection from the public and remittance to Government of the tax in respect of totalisator betting, and licensed bookmakers—on and off the course—should be responsible for collection of the tax from their clients and remittance to Government.

Question 182.—Do you consider it practicable to extend the betting tax to other forms of betting? To which and how?

Apart from extension to Dog Racing, if this form of entertainment is introduced into India, I do not consider it practicable to extend a betting tax to other forms of betting which in any event are illegal and should remain so.

Question 183.—Have you any suggestions to make regarding the tax on prize competitions, e.g., on crossword puzzles? To what extent is uniformity between States desirable in regard to rates, etc., and what steps would you take to bring about such uniformity? What suggestions can you make in regard to preventing evasion or avoidance to the tax?

It is suggested that a tax at the rate of one anna in the rupee should be imposed on all entrance fees collected for prize competitions, including Crossword puzzles, and that collection and remittance to Government should be the responsibility of the promoters of the competitions.

Betting and Prize Competition taxation should be uniform throughout India and therefore it is desirable that it should be provided for by Central legislation.

of its replacement over and above its original cost should be charged against the revenue of the business and at the same time the initial depreciation allowance should be given up and the ordinary depreciation allowance deferred for five years, certainly has very strong arguments in its favour, the most attractive being, in the view of this Chamber, that the amount of relief to be immediately allowed would be based on actual extra cost of replacement, as against a notional cost implied in this Chamber's original suggestion, and from the point of view of the Revenue, the calculation of whatever special allowance is to be given undoubtedly is much more welcome when based on actuals than on notional figures.

6. In effect, if this suggestion is accepted, the Revenue will be allowing immediately approximately 7 annas in the rupee on the extra cost of replacement and against this the Revenue would save itself the initial allowance of 20 per cent. and the additional allowance of say, on average, 10 per cent., that is to say, the Revenue would be saving 7 annas in the rupee on 30 per cent. of the extra capital cost. Thus, the immediate cost to the Revenue would be something in the order of 7 annas in the rupee on 70 per cent. of the extra cost.

7. In addition, the Revenue would, over the next four years, save the tax on the remaining four instalments of the additional allowance.

8. From the point of view of industry, depreciation, as this Chamber understands it, at the normal rate of say 10 per cent. would be allowed on that portion of the replacement cost of the asset represented by its original cost, i.e., on Rs. 100 as compared with the replacement cost of Rs. 300 and in the sixth year, depreciation would start to run at the normal rate on the extra cost, i.e., on the remaining Rs. 200.

9. If something on these lines could be allowed, this Chamber agrees that it would go a long way towards assisting industry over this difficult problem of finding the necessary finance to meet the extra cost of replacement.

10. The alternative suggestion, that a Special Replacement Reserve might be allowed for specified industries of national importance is closely allied to the suggestion originally put forward by this chamber in its reply to Question 61, except that our recommendations have now been qualified by the proposed limitation to industries of national importance.

11. This of course, is a new line of thought in relation to Income-Tax Legislation and, as was agreed at our meeting with you, so far as we know, Section 56A is the first time that any particular industries have been singled out in an Income-Tax Act for special treatment. In the view of this Chamber this differentiation in favour of certain specified industries is unfortunate. We think that all industry, of whatever nature, creates wealth and employment and it quite frequently happens that the so-

greatly to national and State revenues by the various special Duties and taxes imposed upon them. If this view is accepted, it must follow that any Income-Tax relief should be allowed equally to all types of industry.

12. Of the two suggestions on which we have been asked to offer our comments, it will be seen from what we have said above, that we are in favour of the first one, that on replacement of pre-War installed equipment, the

extra cost should be allowed as a charge against revenue the initial depreciation allowance being given up and the start of the ordinary allowance being deferred for five years.

In conclusion, I would like to express to the Chairman and Members of the Commission our appreciation of the very kind reception which was given to us on 28th April.



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MERCHANTS' CHAMBER OF U. P. (KANPUR)

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART I—THE TAX SYSTEM.

Question 1.—Tax is a share in the income of citizens which the States under their respective constitutions, laws and sanctions appropriate in order to secure the necessary means for the governance, defence and procurement of services and welfare conducive to the general interest of the communities they seek to govern. It is thus a compulsory contribution to the State from the private wealth of citizens and even from aliens subject to its jurisdiction over them for reasons of residence and/or property holdings. This contribution is enforced, for the most part, without reference to either special benefits conferred or any *quid pro quo* on individual basis. Social obligations of any individual are conditioned by the earning capacity of such an individual, the general run of the prosperity of the society of which he is a member and the manner of governance to which such a society is subject. The pivots on which modern systems of taxation revolves is social solidarity from out of which arises a sense of common social obligation of an individual to the society of which any such individual is a member. The surplus left after meeting all the needs of subsistence of a citizen and his family from the income of each citizen will thus be found the basis on which any demand could be made of him for contribution towards the maintenance of public services.

The main object of taxation should, therefore, be the procurement of necessary revenues within the capacity of each tax-payer and the sustenance of all the means of progressive production of wealth in the State without impairing in the process of tax collection any factor of production. Thus a tax is good if it brings in adequate revenue without much hardship to the tax payers and if it does not discourage productive activity. The tax mechanisms and their administrations should be designed so as to stimulate production and employment and to afford little chance and inducement for evasion or avoidance of taxes. The taxes imposed ought not to be such as cannot be abandoned or modified, from time to time in order to avoid maladjustments in economy. A tax is useless as revenue to a state if in collecting it, a considerable portion of income therefrom has to be spent.

The criterion of capacity to pay on the part of an individual citizen is obviously influenced by that citizen's wealth and earnings. Raising the standard of life of the average citizen in a progressive manner and in that process of elevating the economic condition of the masses would appear to depend upon a progressively increasing provision of goods and services by the common efforts of the community than upon the mere provision of social services by the State and the pulling down of the relatively wealthier citizens and their wealth. Provision of security and good Government and the holding and maintenance of services related thereto have been and are the primary responsibility of the State. Besides this, the creation of conditions conducive to a progressive increase in the provision of goods and services by the common efforts of the community is the secondary responsibility of the Government. Development Schemes of non-proprietary character conceived and executed by the State in the interest of the community as a whole, with the sole intention of fulfilling the secondary responsibility have, therefore, a place in the role of the State. Reduction in inequality of income and wealth within limitations will thus be found incidental to the latter of the two functions of the State and cannot be the objective of tax policy.

In view of the need for a progressive increase in the production of goods and services by the common efforts of the community, any tax policy must encourage and afford incentives to work, to save and to invest. The realisation of tax according to the capacity of each individual citizen to pay, without in that process impairing productivity, obviously throws upon the relatively wealthier and better-income citizens a burden consistent with their wealth and earnings. The projection of this principle to wilfully reduce inequalities of wealth and income in the case of India will only harm productive efforts and tend to kill incentives to work, to produce and to invest as is being witnessed these days. The wealth holdings and the income of the few on top levels in India are not such that their pulling down and redistribution on any equitable and wide basis will secure for the average citizen even a fraction of his daily needs. On the other hand productive efforts, enterprise and progress, in whatever little scale they are possible today, will stand atrophied. It is, therefore, felt that the reduction of inequalities of income and wealth should not be attempted through means of taxation, unless the aggregate production of goods and services and their stock at any time in their relation to necessities and comforts of

life in India are at least equal to the demand for them, if they are not in excess of such a demand. The use of taxation as a leveller of income and wealth is not suitable to Indian genius and inhibitions. It is more in the dissemination and practice through native education and culture of those concepts of living traditional to this country that has to bring about the use of wealth and income by those that possess, for the common good of the community considering, themselves as trustees of such wealth and income. That is one of the main reasons why Manu, the Great Indian Law Giver of all times favoured indirect taxes more than direct ones.

Estate and Death Duties have come to occupy a distinct place in the scheme of modern taxation. Their primary objective is the reduction of inequality in wealth holdings. Their use as current revenues of the State is only incidental because by their very nature they cannot form the backbone of the revenue mechanism of any State. The duration of fruitful yield from this source is obviously limited because of these duties surrendering themselves before the law of Diminishing Returns sooner than any other mechanism of taxation. These duties are in the nature of taxation of capital at the death of a person commanding its ownership. Any mechanism of direct taxation that subjects capital to tax in the process of its birth and growth should, therefore, be abandoned and losses contingent upon such abandonment in the present context of an economy, should be made good through Estate Duties that have now come to stay.

The disincentive effects of any taxation proposal will have to be carefully weighed and determined in the present context of our economy because they have been found to generate undesirable repercussions on the economic growth of society. There should always be an optimum level from time to time for the levy of taxes on profits. If the levy is lower than this optimum, revenues will suffer and at the same time load on others increases. If the rate of levy is higher than this optimum, as it is tending to become these days, complacency in enterprise sets in hampering efficiency, overlooking wastes and depriving productive mechanisms of the means whereby capital equipment can be provided and maintained. This results only in the ultimate fall of output without taking notice of consumer demand.

As regards savings, individual savings will appear to depend primarily upon the existence of surplus resources after essential expenditure including tax expenditure has been met. Incentive in the form of interest or earnings that those surpluses can bring in will result their being conserved for further use in production. The confidence that such resources will not at any time be confiscated or wasted through misuse, will canalise them into desirable productive activities. Any form of confiscatory taxation will be found to hamper accumulation of savings by denying these three essential ingredients mentioned above. Hence any Government should see that, before new burdens are imposed on an industry or enterprise, the net earnings thereof are positively in excess of its respective requirements to maintain, expand and account for progressive increase of the products it turns out.

Inflation and deflation come under the jurisdiction of the monetary policy of Government. Monetary policy in turn will appear to depend upon the trends of trade, both internal and external, the balance of payments position in respect of the country as a whole and the elasticity in the operations of financial institutions like Banks, Insurance Companies, Investment Trusts, etc. Besides, the quantum and spread of currency at any time have their own effects on inflation, and deflation. Instead of attacking inflation or deflation from these bases, taxes should not be used for countering inflationary or deflationary tendencies.

Maintenance of the external balance of economy will be found dependent on ultimate analysis, on the trend of international trade and prices. Stability of internal prices will be found in this context as a desirable feature but this again is predominantly a currency and monetary matter. In so far as protection to certain domestic industries and mutual concessions arising out of international trade agreements are concerned, taxation will be found to have been affected by them and that for this matter cannot be seriously opposed. The reverse process of holding the maintenance of external balance of the economy as an objective of taxation is to deny trade and currency their legitimate jurisdictions.

Judged from the principles so far enumerated the Indian Tax system cannot be characterised as being conducive to progressive economic development with almost every individual citizen having an urge and a part to play

therein. It seeks to tax capital in most respects and lays undue emphasis on the illusive reduction in inequalities of wealth and income ignoring in that process the primary functions of the State and the need for the provision of ever increasing supplies of goods and services.

It is common knowledge that the Indian tax system specially direct taxation hinders the growth of saving and capital accumulation. So far as corporate savings are concerned, they have dwindled in recent years under the impact of cost price inflation on the one hand and heavy taxation on the other. The pressure of incometax, high import duties on raw materials and capital goods and heavy duties on exportable items like jute manufactures, tea, vegetable oil, etc., have crippled quite considerably the earning capacity of major industries. Many of the important industries are not now making even the marginal profits necessary to be able to provide for the replacement of the existing worn out plant and machinery. A close examination of the trend of Industrial Profits would reveal that in many cases, even the provision for additional depreciation on a tax-free basis could not be made because of the poor volume of profits ploughed back. A scrutiny of the trend of profits, taxation, dividend payments and retained earnings of the industrial sector in the U.S.A. will show that the corporate taxation has been definitely lower and only recently earnings were considered ample. It has been possible to plough back large sums into business out of current earnings as the return on net investments has been much higher there than elsewhere. The rate of taxation on profits in India does not allow proper provision for depreciation and hardly leaves any margin for expansion. It is, therefore, not only extremely regressive but also a tax on capital formation and savings. It is necessary that in regard to taxation of undistributed profits, the Corporation Tax should not be levied altogether. This concession may mean an appreciable saving in the industrial sector and in all the maximum relief, including the additional depreciation allowances would be less than Rs. 15 crores annually. As against this much wanted relief, Estate Duty which will be in the nature of tax on capital at death of the holder may be depended upon for sometime to make good loss to the Exchequer from this source.

Question 2.—In India the pressure of direct taxes (Incometax) fall upon only 0.25 per cent. of the total population, 99.75 per cent. of the population being therefore, held as having no capacity to pay any direct

tax in terms of their income. A fair share of indirect taxes is also borne by the same group because of its varied consumption. Rural population hardly contributes anything by way of direct and indirect taxes excepting land revenue which is an inelastic source of revenue. The pressure of almost all taxation will thus be found to fall mostly upon urban dwellers. In this context the Indian Tax system cannot be characterised as being governed by the principles of equity. Inequity of the Indian tax system has developed into an unavoidable evil in the context of our both undeveloped economy and modern ideas of Government. In order to secure equity in the Indian tax system, certain basic principles, touching upon the administration of Public Finance and determined as applicable to underdeveloped countries, hold good for application. These are (1) the State Government's Budget as well as that of the Centre if it can be so helped, must be kept small, (2) it must be kept balanced, (3) the pressure of taxation therein should be more on consumption than on savings, (4) if deficits cannot be avoided, then the scope for raising the revenue necessary to bridge the gap between the estimated revenue and budgetted expenditure and also capital deficits should be sought only in the issue of long terms bonds, (5) all borrowings except floating debts and ways and means advances must be only for productive investments, unproductive investments and all other recurring expenditure being met solely out of revenues.

Question 3 and 4.—Injudicious extension of the principle of ability to pay and the application of taxable capacity only to a particular section or sections of community have given place to maladjustments not only in our productive efforts but also in the political and economic arena. In an authentic study carried out on this subject recently it was shown that whereas the 'lower class' population at 87.6 per cent. of the total population of India contributed only 13.67 per cent. of the total tax revenue, "the upper and middle class" population at 12.4 per cent. of the total population contributed as high as 86.33 per cent. of total tax revenue in this country. The same study also revealed that the contribution of revenue from taxation mostly came from the urban areas. Looking at the per capita contribution classwise it was found that the incidence on each earner was almost hundred times more in the case of upper class as compared to lower class. The following table fully illustrates the position:

	Population in Provinces			Contribution to tax revenues		Per capita contribution	
	In millions.	As a percentage to total.	Earners in millions.	Rs. in lakh.	As a percentage to total.	By population.	By earner.
						Rs. as. p.	Rs. as. p.
Lower class	213	87.6	85.2	63,75.89	13.69	2 15 10	7 7 7
Upper or Middle class	30	12.4	6.0	402,48.83	86.33	134 2 7	670 12 11
TOTAL	243	100.0	..	466,24.72	100.00	..	..

It is evident that attempts at garnering the same number of rupees from the same sources are still on without little thought of the fact that we are heading towards economic insolvency. We have to modernise our tax revenues before we modernise our Governmental expenditure. It is also clear that the lower class man cannot contribute in any appreciable measure the increasing resources necessary for the upkeep of administration as it is being conceived and executed every day in India since his means are low. Government had been turning their attention rather ruthlessly to the man in the upper class. This the Government could do with the help of political power resulting from adult franchise in India whereunder out of an electorate of 121 millions, only about 8 lakhs of individuals pay direct taxes and 99.5 per cent. of the electorate contributes only 20 per cent. of the indirect taxes thus enjoying 700 per cent. political power without paying taxes as compared to the taxpaying sector of the population. But it is forgotten that the inexorable laws of economics are bound to operate and the law of Diminishing Returns has already set in. The contribution exacted from the upper class men inordinate and yet there seems to be no relief for the lower class men.

Question 5.—The proportion of tax revenue to national income in India is relatively small as compared with several other countries. But that does not indicate that there is yet any taxable capacity in the country left to be exploited and that as a consequence thereof there is any scope to raise this proportion. This National Income must be correlated to the National population and area in each case before the proportion of tax revenue in each case can be viewed in its correct perspective.

This apart the economic development and productivity behind the national income in each case have to be taken into account, before the proportions of tax revenue to national incomes and their trends are considered. For the potential resources, large area and the huge population that India has, her national income at about Rs. 9,000 crores a year must be considered very poor indeed. While the aggregate national income of India may work appreciably more than Canada or very near the U.K., the per capita national income is too poor to compare with any civilised country. Per capita income in India is 1/9th that of Norway, 1/11th that of Australia, 1/13th that of U.K., 1/21st that of Canada and 1/36th that of U.S.A. With the very small per capita income in India the content and quality of personal expenditures in India is largely essential and any measure of taxation to secure public revenues dependant upon predetermined and rigid public expenditure is to deprive personal consumption expenditure even on necessities. The Indian tax system must be made to depend upon national savings resulting out of the deduction of national personal expenditures from the national income and not on mere national income. In fact there is the case in India for cutting out most of the existing taxes in order to provide incentives to save, to produce more and to profitably canalise savings into further production.

Question 6.—No. All direct taxes, and specially taxes on income, affecting as they do only certain sectors of economy and not the entire community have far reaching consequences on the economic development of society should the section of the society that they affect loose the

urge to earn more. This is particularly so in the case of society where those that pay direct taxes are in very small proportion to the community as a whole. In the U.K. about 44 per cent. of the population pay incometax, in the U.S.A. about 37 per cent., in Australia about 34 per cent. The income tax paying population as already indicated forms only 0.25 per cent. of the population of India. When it is remembered that income tax makes up as much as 45 per cent. of the total revenues, it will be realised how heavy is the incidence of this tax on an insignificant minority and how a vast majority to the tune of 99.75 per cent. of the population remain untouched at least to the extent of 45 per cent. of the revenue. Fixture of proportions between direct and indirect taxes on the balance of revenues and the orthodox notion of dividing revenue collections as between direct and indirect taxes at fifty fifty can have no application to India in the above context. Considerable relief in direct taxes at last until such time as we achieve alround progress and direct taxes can become broadbased and the increasing exploitation of indirect taxes as the source of revenue are called for in the present circumstances of our economy.

Question 7.—Yes. All State enterprises including productive works should be able to pay more than the expenditure involved in their operations and maintenance if they are all run purely on business scale. Railways, Defence installations and such other national monopoly items should also be able to show appreciable surpluses on their operations through sound management thereof.

Question 8.—Yes.

Question 9.—No. Cesses once initiated take ultimately the form of excise exactions. Further levy of cesses for specific purposes militates against the principle that no fiscal receipts in the public exchequer should be earmarked as a rule for any specific purpose. This apart cesses impose unduly heavy burden on one sector when that sector has also equal claim with the others to progress without having to pay any special price for the same.

Question 10.—The inexperience of Government unsuitability of available machinery and bureaucratic outlook have been responsible for the injudicious application of capital and efforts and waste of public finance in so far as almost all State undertakings are concerned. These factors and the increase in the cost of administration have indirectly added to our burden of taxation. Government undertakings must be made to function as private commercial bodies with the applicability to State enterprises of accounting methods, computation of costs, depreciation allowances, taxes on profits, subjectivity to industrial and commercial laws and the control and regulation of Industries Act, etc., as they are applicable to private enterprise. Above all it should be possible for every citizen to know clearly and without any expert advice the method of working of any state enterprise and to judge if it has been helpful to public revenues as private enterprise. Pricing policies and limitations on profits as are applicable to public utility undertakings run under Government authorisation and monopoly conditions must hold good in the case of almost all State undertakings.

Question 11.—Surpluses earned after earmarking for depreciation and various reserves as a very sound private concern would do should be credited to a fund specifically got up to finance projects of development. Expansion of undertakings and reinvestments needs thereof must be met from this fund. No project of development should have anything to do with the revenue budgets of Governments.

Question 12.—Income and occupation are the two factors that should be the basis of differentiation in examining the incidence of taxation on various classes of people.

Question 13.—(a) No. Please see explanations in answers already given.

(b) No. The burden of tax revenue is greater in certain States when the same is viewed in terms of the population thereof. Neogy Commission would not have been necessary to consider and decide upon the division of revenue had fair distribution between different States been there.

Question 14.—Yes. The incidence of taxation, both direct and indirect, is relatively greater on persons engaged in industry and commerce and in urban areas than on persons engaged in agricultural and allied occupations and in rural areas. The shift in income has been more towards the latter class of persons, the former being soaked almost dry by taxation and inflation.

Question 15.—Yes. Specially in connection with income tax in direct taxation and sales tax in the indirect taxation. The law in both respects has become so complicated and administrations thereof have become so complex that any assessee with a fair income or turnover to account for is obliged to maintain not only experts to

comply with the provisions of law and orders passed by the authorities but also a departmental set-up in full.

Question 16.—No. the benefits accruing from public expenditure to different classes of persons have no relation to the burden of taxation on those persons nor the tax-levying authority takes into consideration such benefits while imposing taxes. Tax is levied in relation to the income of the people regardless of the advantages derived from expenditure by the Government.

Question 17.—See answer to Q. 14.

Question 18.—Development programme of the country in public sector should be based on the possibility of causing savings and harnessing them through Government borrowing. Taxation should in no case be used for financing development programme in the existing economic set-up of India.

Question 19.—Development of non-tax revenues, economy and rationalisation in expenditure and prevention of tax avoidance and tax evasion should play their part in the order stated above in maximising the resources required for the financing of development. Higher rates of existing taxes and fresh taxes should not have any place in financing development programme.

Question 20.—The Tax policy of the state should be so designed as to encourage savings, which in turn could be canalised for financing the development schemes in both the private and public sectors. It is evident from the figures of the American Treasury Receipts that when reductions were effected successively in surtax rates in respect of taxation on income, not only the number of persons reporting to incometax had increased but also the net tax collections in dollars from such persons were about fivefold within eight years. Our tax policy should aim at covering a wide range of the population by measures of taxation as has already been indicated.

If the tax policy is such as will encourage investments and endanger in the least of such investments being subjected to confiscatory assessments or legislation, quite a good deal of the finance required for development programmes might come out of foreign resources also, in addition to the hidden resources within the country.

Question 21.—See answers to Question No. 20 and Question No. 1.

Question 22.—In the recent past the rate of private capital formation has actually been lower due to a variety of reasons. The most important factor which is responsible for the lack of investment incentive in the private as well as public sectors is the harassing and cumbersome procedure adopted by the incometax authorities in instituting enquiries from investors regarding the sources of capital invested by the individual. Instances are on record where firms which started on borrowed capital had been forced to close down because they failed to satisfy the incometax authorities about the source of their investments in the manner of prescriptions laid down by the authorities and accordingly they were taxed not on the income of the concern but on the initial investment thereof. Further, the prevailing recession in prices of manufactured products accompanied by buyers' resistance and uncertainty of markets consequent upon the decline in the internal as well as the external demand and the mounting expenditure on industrial production due to the enforcement of various social security legislations have reduced considerably the scope for industrial profits. All these factors have, therefore, helped in discouraging capital formation. In support of the view that the rate of private capital formation has been lower, it may be pointed out that during the year 1952 consent was given to 254 companies to issue capital amounting to Rs. 39.8 crores under the Capital Issues Control Act as against consent for 343 companies given during the year 1951 for a total capital issue of Rs. 59.6 crores.

(ii) Yes. High Cost of living consequent upon inflation has not provided any scope to savings to wage and salaried earning classes in the lower and middle class strata insofar as individuals are concerned. The parsimony shown by the taxation authorities in the matter of Depreciation Allowances and Replacement Costs and the levels at which corporate profits are taxed leave little with Corporations by way of effective savings and their appropriate canalisation. Social security measures such as Employees Provident Fund Schemes, etc., take away into public sector even the little savings that could be shown by Corporations for use in private sector. Institutional Investments by Banking and Insurance Companies are hemmed in by restrictions and almost all these Companies can offer is diverted into the absorption of loan issues and Governmental borrowings with little incentives left for better and more profitable investments and returns.

Question 23.—In view of the fact that persons in the middle income group regard their savings mostly as a provision for the rainy day and in view of the fact

that there are no social security benefits as invalid allowances, widows' pensions, unemployment benefits, childrens' endowments, etc., which are in operation in foreign countries such as U. S. A., the U. K. or Australia etc., every one in India has almost to depend upon his own savings. Accordingly, any tax relief granted to persons in the middle class group will really encourage savings rather than adding to the consumption expenditure. As persons in the middle income group will not very much be effected by death duties for the present, tax relief in respect of direct taxation insofar as they are concerned may help them to save and to invest.

Question 24.—In the first place the Central Government should announce that additional output as envisaged by the Planning Commission after 1956-57, will, if canalised into productive investments, be free from crushing weight of direct taxation such as incometax for a substantial period. Even with this announcements and the implementation thereof, it will be difficult to realise the target of 50 per cent. of additional output going to investments each year after 1956-57 because we would have reached a stage in the supply of commodities and services by then only to 1939 standard.

Question 25.—As has already been mentioned above, in answer to Question 23, Indians for the most part are instinctively and traditionally inclined to save as much as possible for the purposes of meeting conventional necessities and security needs. Consumption standards as are conceived abroad are practically unknown here in India. For the most part the country is on the subsistence level. Persons on top income groups, say beyond Rs. 6,000 a year standard, form a very small proportion of the population of India, perhaps 0.013 per cent. The elasticity for variation in consumption standards are, therefore, absent. As is well known, savings of the poor and middle classes used to be canalised in dead savings in the form of gold and silver and ornaments. But now with the development of credit institutions and stock and share markets, the channels for investments have become diverse. Financial institutions such as banking and insurance companies should also be capable of attracting a good deal of the savings of the people. Accordingly, it is suggested that the tax policy of the Government should be so formulated as to ensure persuasive incentives and a high degree of safety to savings and investments.

Question 26.—The tax policy of the State is payable of playing a vital part in the productive system of the country. All direct taxes on production such as sales tax, terminal tax and octroi charges and excises and cesses on industrial raw materials and manufactured goods, etc., affect the cost and structure and the price of commodities by imparting rigidity to them. The impact of these levies is felt by the producers more when the market turns to be a buyers' one and consumers resistance is offered to supplies and output. Similarly indirect taxes also affect production.

The multiplicity of taxes in India in respect of the same commodity especially salestax and its lack of uniformity, affects production adversely. For instance, imposition of varying rates of salestax on the same commodities in different States induces the consumers in one States to draw their requirements from the States where the rates of salestax are the lowest by indulging in evasion and misreporting. This in turn stimulates the production in such States where natural factors do not warrant such activities. Again, the lack of uniformity in octroi charges and terminal taxes hampers production to a great extent and often leads to the migration of trade and industry from the place where these charges are high to places where they are low. The uniformity of taxes, both indirect and direct, will stimulate production in the States on an equitable basis and will encourage adherence to economic location of industries in a more natural manner.

Question 27.—The judicious use of tax system in order to secure priorities in the development programme in private sector will yield appreciably good results. Conservation and flow of capital, easy procurement of capital goods at the least possible cost, freedom of raw materials used by industries from taxation, elasticity in the application of taxation measures affecting commodities such as excise duties and salestax should be some of the basic considerations in shaping and exploiting the taxation system for the procurement of priorities for the development programme.

Question 28.—Answer to this question has been given in parts at various places in the foregoing answers. A tax policy cannot be taken as a static phenomena. It is a dynamic and evolutionary development consistent with the economic progress, potential resources and productivity of the community. The limitations and possibilities of tax policy as an instrument of economic development can be judged only in the context of political institutions on which the community seeks to depend. Ideals of democracy and freedom of the individual can-

not march together with a regulated economy and communism. In so far as 'mixed economy' which we are experimenting in India at the moment only confines itself to the embrace by the public sector of Defence and Defence strategic industries and public utilities, leaving most forms of economic activity to the private sector, the functions of the State should not be allowed to make inroads into the economy in private sector unless under a state of emergency or War. In the circumstance explained above tax policy will confine itself very much to the primary functions of the State, leaving economic development to fashion according to the genius of the community and providing adequate and necessary incentives from time to time for such economic development. What according to some, is being done at the moment in India, is the dependance on the possibilities of tax policy as instrument of development without realising the grave limitations of the tax policy in shaping economic development.

Overall demand in a community will be found to depend on ultimate analysis on the income of the community and the resources it has to gather that income. These touch upon productivity both individual and national. Tax policy by itself cannot influence overall demand in any appreciable manner. Maladjustments in overall demand that may develop from time to time in the economy of the community may, however, be considerably corrected by a judicious tax policy and its administration.

Reduction in consumption and unessential investments are influenced more by the availability of purchasing power, native habits, inhibitions and conventions and the state of economic prosperity. In a country like India where a substantial majority still live under sub-human standards this is not a problem that calls for any attention. Tax policy, it is afraid, cannot do much here so far as India is concerned. Tax policy can certainly help economic development at the moment by affording positive inducements for desirable investments. Investments are shy and halted at the moment because savings are discouraged by the present tax policy and administration. There is considerable scope for action here. The use of tax policy to effect redistribution of incomes so that economic development may be broadbased with the participation therein of as many as possible would have merited attention, had we in this country the know-hows and equipment combined with individual productivity upto a certain minimum standard. Any attempt at redistribution of incomes through tax policy in India at the moment will only lead to the impoverishment of the insignificant minority of well-to-do without in any way bettering the condition of 99.75 per cent. of the teeming Indian population. There is the additional danger of destroying in this process whatever little 'knowhows' and equipment we have natively rooted in India at the moment.

Question 29.—In so far as monetary policy is concerned certain controls as instruments of planned economic development may be thought of. To thinking of controls in the same breath with tax policy will be found incompatible with economic development under democratic conditions. Tax policy must have nothing to do with controls in any shape or form.

Question 30.—The present tax system in India more than makes for a reduction in inequalities of wealth and income and this feature of tax system has not helped the poor in improving their lot while it has destroyed the utility of the rich to the community.

Question 31.—With the enactment of the Estate Duty Act, we have provided for securing a large degree of economic equality. Estate Duty, having grave limitations as a revenue counter with regard to both time and quantum factors in a country whose overall exploited wealth is poor, should be capable of being used as a substitute for losses arising out of reliefs extended in direct taxation and modifications made in indirect taxation in order to provide effective incentives to capital formation and higher production.

Question 32.—Public expenditure may be more effectively and judiciously used in achieving greater measure of equality of income than the tax system.

Question 33.—See relevant answers under the heading 'Incometax'. Foreign capital flowing into India in the form of capital goods and technical skill unavailable in India might be let off with a relatively lower pressure and burden of taxation as compared to foreign capital migrating into India for trade, banking and insurance purposes. Similarly ample scope may usefully be extended to the exploitation by foreign capital in India of secrets and patents of foreign origin with materials available in India over a period of years with an eye on the development of India's export markets and scientific research such exploitation will give place to. The judicious use of tax system by timely adjustment of commodity taxes (indirect) and direct taxes offers sufficient potentials towards this end.

Question 34.—Succession and Estate Duties on all properties other than agricultural land as revenue counters are hemmed in by grave limitations both in respect of time and yield in a poor country like India where those capable of responding to such duties are concentrated in urban areas and are very few and far between. If economic development takes place rapidly from now on the beneficiaries of this development for the most part will be the lower and middle income groups rather than the wealthy because of the changing concept of ranks and social order. A forecast of better returns from Death and Succession Duties cannot, therefore, be made even if the potentials for economic development are taken into consideration. Terminal taxes on goods or passengers carried by Railway, sea or air are at best an extension of the principles of octroi levies and serve merely as a source of local finance irrespective of by whom and where they are collected. When it is realised that a terminal tax is in the nature of an octroi without refunds adversely affecting inter-state trade and that the rate of levy of this tax should be very low in all cases, the potential of this tax as a source of revenue is left in doubt. Further salestax and excises, which already impose burden on commodities and indirectly on persons consuming them, leave little justification for the levy of terminal tax. Taxes on railway freights and fares will again be found as having very limited scope for exploitation and they are no more than an enhancement of railway freights and rates. There is no elasticity in this form of tax. Industries and commerce which contribute towards railway freight. For the most part and third class passengers who contribute towards railway fares for the most part are apt to resent against such levies in the present economic context. Taxes on transactions in stock exchanges and other future markets though capable of yielding limited revenue and very much more for certain States as compared to almost nothing for some states in India are worthy of consideration. Since the tax does not impose any burden on productivity and effective economic efforts, it could be levied until the Law of Diminishing Returns sets to operate in respect of this tax. Taxes on sale or purchase of newspapers and on advertisements published therein are dealt with in Answer to Q. 126 following.

Question 35.—Taxes on capital do not offer any scope for exploitation as taxes on income already impose heavy burdens and savings and capital formation are almost becoming impossible. Instead of progressive economic development for which we are planning, we will be found to be administering regressive economy if we start imposing taxes on capital. Estate duty is itself a tax on capital at one stage of its existence and any further scheme of taxation of capital in the process of its formation has least justification.

The myth of salt duty affecting the poor and sentimental considerations attached to the levy of this duty must be given up. Even without salt duty, salt does not figure as any free item or item of lesser burden to the poor. Its consumption will always be limited. Further the principle that every citizen ought to contribute his mite to the State and the fact that in a poor country like India where the expansion of direct taxation any further is impossible and all the forms of indirect taxation do not touch all universally offer sufficient justification for the reintroduction of salt duty to make up for the revenue of the State.

Land revenue having almost been static all these years despite better prices obtained for agricultural commodities over the last few years and with the reform of land tenure system offers scope for better exploitation. Surcharges will be found conducive to revenue accretions of the States. The biggest obstacle here will be the political consideration of a vast majority of agricultural population having franchise rights. A 25 per cent. increase in land revenue could be easily accounted for from this source. Betterment levies and agricultural incometax offer considerable scope for revenues of the States especially in the context of the development schemes undertaken in rural areas. But here again political considerations may prevent our exploiting the resources to the limits of their possible yields.

Policy of prohibition has clearly been a failure occasioning at the same time considerable loss of revenue to the States. Here again sentiments rather than hard facts of economics have been the chief consideration. A considerable loss of revenue occasioned by the policy of prohibition to gain a mythical national advantage could be avoided by scrapping this policy. Provincial excise which is in fact intended to discourage consumption could be attuned from time to time and fixed at levels where revenue will not only come in but will at the same time discourage anyone from becoming addict to alcohol and drugs.

Question 36.—Yes. The process of levy basis for assessment and the points at which the levy can be justifiably imposed must be carefully considered when deciding upon taxing unearned increments in value of

land and other property as a result of public projects of development.

Question 37.—Integrity, a sense of human touch about enquiries and dealings and a sense of awareness to realities rather than legalistic interpretation of relevant Acts and Rules and an attitude of ruthlessness in assessing and collecting taxes on the part of the taxation machinery will keep tax evasion at the minimum. The removal of burdens of direct taxation to a point that can be borne safely by the assessee without endangering his capital will also account for a considerable abatement in ingenuity employed to escape taxation altogether and to indulge in evasions. Public relations' work on behalf of the assessing and collecting machinery among assessee to tax and exhortation by men of influence to adhere to the obligations imposed on citizens by example and precept will also account for increasing receipts from existing sources of revenue. These considerations apart, it will be observed that irksomeness and harassment caused by any one taxation measure or control mechanism have their own repercussions on anyone properly accounting for resources, their use, and earnings with the result that most money is made and many transactions are put through out of account making assessments and collections of taxes impossible. These adverse repercussions on productive efforts being accounted for must be avoided if receipts from the existing sources of revenue are to be stepped up.

Question 38.—We cannot recommend any new sources of taxation in the present state of our economic development.

Question 39.—As a rule the imposition of surcharges on any indirect tax must be avoided. Even in the case of direct taxes on which the impositions of surcharges are thought of consideration must be had for factors such as the possibility for overall revenue shrinking the burdens that such impositions might cast on the payer or the class of payers of the tax concerned. Judged from these standards, Incometax and supertax surcharges appear inopportune and undesirable at the moment. Surcharges on subjects covered by Article 269 of the Constitution of India should always be out of question for most of them are themselves surcharges on prices of goods and services concerned.

Question 40.—Please see answers to question 1 *supra*. Inflationary or deflationary situation arise out of factors governing currency and banking and the nature of cost structure for the time being in both industrial and agricultural sectors. Tax policy as an instrument for dealing with such situations offers little or no scope in India. India is a country where the population lives on an exceedingly low standard of living and in which the ratio of unused resources to population is very high. We can, therefore, anticipate a rapid improvements in living conditions as the utilisation of resources progresses. The impact of new investments upon living standards can be both rapid and significant if the rate of population growth does not continue as at present. To the extent, therefore, of attracting new investments, a sound tax policy may assist upto a certain point. If taxation is used to soak the few well-to-do under the illusion of creating a new social order and public sector spills forth such revenue collections in social or security services, the result in the absence of balanced development in India yet, will be the creation of inflationary conditions where too much money will be found chasing too few goods necessitating all sorts of economic controls. Example of such a development is provided by the happenings during the second World War in the economic sector of India. The inherent weakness in any tax policy is that once it is set in motion its withdrawal is found to bristle with difficulties to the extent of making withdrawals and even abatements impossible. A tax policy cannot, therefore, be expected to bring about the deflationary situations easily. It is the state policy rather than tax policy that will be found to have any bearing on inflationary or deflationary conditions.

Question 41.—Just as inflationary condition is the symptom of the availability of goods and services below the overall availability of purchasing power deflationary condition is the symptom of scarce availability purchasing power in relation to the supplies of commodities and services at any given time. It is the extent to which cost structure in agriculture and industries enjoy resilience and offer scope for adjustments supply of goods and services will automatically adjust themselves to the demand for them and *vice-versa*. At the moment direct taxes in India touch an infinitesimal fraction of the population and that too at upper levels. The taxation on income at the top most level during the War did not relieve that period of inflation because of this main feature of indirect tax in India. Consumption cannot be restricted by direct taxation unless such taxation embraces a sizeable proportion of the population. Mere relief in direct taxation at the time of deflation does not help very much either because direct taxation influences the cost structure only remotely and indirectly.

The time lag necessary for adjustments in production, supplies and consumption under either deflationary or inflationary conditions is beyond the purview of taxation and hence direct taxes cannot be depended upon to correct currency and credit maladjustments. All indirect taxes do influence prices directly and a few of these costs also to a considerable extent. To the extent, therefore, prices have a bearing on consumption indirect taxes certainly help in countering inflationary or deflationary conditions. But to depend on these taxes alone to counter the inflationary or deflationary conditions is to place more than reasonable reliance on tax mechanism as correctness of inflationary or deflationary situations. The element of tax in cost structure these days is considerable enough to influence prices. To the limited extent, therefore, all indirect taxes such as excise duties and sales tax can be depended upon as correctives to ill-developed monetary situations. Adjustments in import and export duties do stimulate or stifle consumption to a certain extent but with so many restrictions and exports in operation in international trade, their influence is not so much as it had been in the past before the World War II.

Question 42.—Please see answers to Questions 40 and 41.

Question 43.—In practice Government sponsored centrally conceived plans of economic development frequently result in sustained inflationary pressures because of the release of resources it engenders in activities having socio-economic significance as against activities involving purely production and productivity. Economic development does not lean on the free play of economic forces. The result is disequilibrium in the structure of currency and credit. With all the Government resources yoked to the execution of the plan and in spite of absorption of all available resources in the country through taxation and loans there is still unemployment, underemployment and deflation. It is, therefore, clear that in order to bring about automatic and timely adjustments in economic disequilibrium such as inflation or deflation, Government financing should not be allowed to have ramifications beyond Government's primary responsibilities. It must be clearly understood that neither Government actions nor Government funds are satisfactory substitutes for private actions and private funds under a democratic climate.

Question 44.—Please see answer to Question 41

Question 45.—Please see answer to Questions 40, 41 and 43.

PART II—DIRECT TAXES INCOME-TAX

Question 46.—Provisions of Section 4A determining the question of residence of an assessee do not require any change but the provisions contained in Section 4B are useless. Section 4B was enacted only for the benefit of Europeans coming for service in this country. The Income-tax Investigation Commission also recommended the abolition of the term 'not ordinarily resident' vide para. 36 of its Report.

Question 47.—Section 2(6C) deals with the term 'income'. It does not attempt to give any definition of the word income but simply says that the word 'income' will include (1) dividend as defined in clause (6A) or (2) perquisites as mentioned in sub-section (1) of Section 7 namely a payment due to or received by an assessee from an employer or former employer or from a provident or other fund exclusive of contributions made by the assessee or interest on such contributions, excepting a payment made solely as compensation for loss of employment and not by way of remuneration for past services or (3) any sum deemed to be profits under the second proviso to clause (vii) of sub-section (2) of Section 10, i.e., when on the sale of any building, machinery or plant, the sale price exceeds the written down value, the difference between the original cost and the written down value is deemed to be the profits of the previous year in which the sale took place or (4) any capital gain chargeable to income-tax under the provisions of Section 12B which is no longer in force, or (5) any business of insurance carried on by a mutual insurance association computed in accordance with Rule 9 in the Schedule annexed to the Act.

These items had to be specified because otherwise they would not have fallen in the definition of 'income'. The definition of 'income' has been laid down in judicial pronouncements but the word 'income' as such has not been defined anywhere and in fact it is very difficult to give an exhaustive definition of this word. Even in other countries the word has not been suitably defined and reliance is placed mostly on judicial pronouncements. One of the authoritative definitions given in a leading case is as under :—

“‘income’ in this Act connotes a periodical monetary return coming in with some sort of regularity, or expected regularity, from definite sources. The source is not necessarily one which is expected to be con-

tinuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall.”

(Commissioner of Income-tax Vs. Shah Wallace and Company).

The principle enunciated above should be adhered to in the connotation of the word 'income' so that any attempt of roping in income of casual and non-recurring nature of capital gains may be avoided. Appreciation in the value of machinery is obviously a capital gain and should not be included in the word 'income'. Moreover it is unfair to assess this capital gain in view of the fact that the replacement cost of the machinery to-day is 4 or 5 times the original cost of the machinery. The industry needs funds for replacement of worn out machinery. It is therefore, suggested that Section 2(6C) should be amended accordingly and the second and third provisos to Section 10(2)(vii) should be deleted.

The definition of the word 'business' in section 2 (4) which includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture has been invoked in numerous cases for assessing what is nothing more than the casual income or capital gain. The Income-tax Act should confine itself only to taxation of income and now that the Estate Duty has been introduced any increase in wealth due to casual and non-recurring gain or by appreciation in the value of property would be automatically taxed at the time of the owner's death. In the recent Bombay Case of Rajputana Textile (Agencies) Ltd. Vs. Commissioner of Income-tax (XXIV IPR-46), the sale of a block of shares by the company was held to be an adventure in the nature of trade although according to its Memorandum and Articles of Association, the Company was not authorised to deal in shares. Simply because several brokers were engaged to dispose of the shares, it was held that the transaction constituted an adventure in the nature of trade and commerce. It was not possible to dispose of a large block of shares without the help of brokers and as such the definition of the word 'business' in Section 2(4) should also be amended.

The inclusions made in Section 2(6C) should all be dropped from the definition of the word 'income' except any business of insurance carried on by a mutual insurance association.

Question 48.—Taxing of capital gains would, it is apprehended, seriously jeopardise the economy of the country. During the war period there may be very great fluctuations in the value of all property and if capital gains are to be included in the assessment, capital losses will also have to be accounted for and deducted out of the income. This will make the position administratively difficult without any appreciable gain to the revenue. Now that the Estate Duty is going to be introduced, the capital gains, if any, would be automatically taxed to Estate Duty on the death of the last holder of the property and this is where the matter should be left finally. As already noted above any excess realisation over the written down value of building and machinery on the sale thereof should not be taxed.

Question 49.—Have you any comments on the present position re: taxation of profits which accrue or arise abroad, on their repatriation to India?

The present position regarding taxation of foreign profits is as follows. So far as pre-1939 foreign profits are concerned, they were till recently liable to duty on being remitted to India. But certain concessions have now been granted by Government (Vide Press Note of Government of India dated the 2nd September, 1951). Those profits are now exempted on remittance if—

- (1) the remittance is received in India before 1st of April, 1954,
- (2) half the amount receipt is invested within three months of the receipt in the purchase of Government securities through the Reserve Bank of India, and kept with the Bank for a minimum period of two years, and
- (3) the remaining half is utilised in the discharge of any outstanding income-tax liability.

As for foreign profits earned subsequent to 1939 they are fully taxed in the year in which they accrue. The foreign income is added to the total income of the assessee and he is taxed on his total world income.

Regarding Indians living abroad who are desirous of returning to India, the Income-tax (Amendment) Act, 1952, provides for exemption from taxation of foreign profits which are remitted to India by such non-resident persons in the first two years of their becoming resident in India. Such contingencies are very real, as restrictions on remittances are imposed by foreign States like Ceylon, Burma, Pakistan, etc. The Provision should, therefore, be amended by extending the time limit to cover such contingencies.

The Committee suggest that foreign profits should be completely exempt from tax, though they might be taken into consideration only for the purpose of determining the rate of tax on Indian income so as to conform to the principle of ability to pay. By the Income-tax (Amendment) Act, 1952, the full amount of the foreign tax or the Indian tax on the foreign income whichever is less is deducted from the total Indian Income-tax payable. This unilateral relief is no doubt good so far as it goes, but the Committee submit that it will be only taking a small step forward if their suggestion that foreign profits should be exempted altogether from the tax taking them into consideration only for rate purposes is adopted. This will facilitate and give a fillip to the expansion of Indian trade and business abroad and will also give them capacity to compete in the world markets. Moreover, foreign income and Indian Income cannot be put on the same basis for the purpose of taxation as the risks and dangers involved in risk capital venturing out are far greater than when it is invested in India. The economic justification to tax foreign earnings is comparatively weaker than to tax Indian profits. Another aspect is that the earning of foreign profits by Indian residents will considerably help Government in its exchange resources. As already indicated the exemption of foreign profits is not likely to result in much loss to the Exchequer as unilateral exemption upto 100 per cent. of the foreign tax or the Indian tax whichever is less is being granted even now. If an attempt is made the Committee have no doubt that the loss to the Exchequer will be found to be negligible, whereas the psychological effect that the exemption of foreign profits will give to our developing trade and business abroad and to our increasing invisible exports will be very valuable indeed. Such funds when remitted to India will add to the capital resources of the country.

Both in the United Kingdom and U. S. A. there is a trend towards exemption or relief for foreign profits. There is greater justification for such relief being extended in India because, on taking overall picture, it will appear that if the world income taxation concept is abolished throughout, the automatic result will be the extinction of the Double Taxation Relief arrangements. As it is, in respect of most countries, India would be the worse off by having Double Taxation Relief arrangements and that is the reason why such relief arrangements existing before independence stand terminated.

Question 50.—The definition of the term 'dividend' given in Section 2(6A) needs no change. Distribution of Bonus shares cannot be treated as dividend as there is no release of assets in such cases. The price of a share in the open market reflects the full value of the assets of the company modified to some extent by its earning capacity and distribution of dividends in the past. By the issue of Bonus shares the value of each share is reduced considerably and consequently if the nominal value of Bonus shares is treated as dividend, the loss on existing shares will have to be taken into account. No change, therefore, is necessary in section 2(6A).

Question 51.—Do the provisions of the Income-tax Act relating to the taxability of non-residents through their business connections in India in respect of income deemed to accrue or arise within the taxable territories (Sections 42 and 43 of the Income-tax Act) affect adversely the interests of persons engaged in foreign trade? If so what modification would you suggest in these sections?

Yes, the interpretation now being placed on these sections very materially affects the interests of persons trading with but not in India and is becoming a strong impediment to the development of that trade in the absence of tax treaty arrangements or Double Income-tax Avoidance Agreements with other countries, particularly the U. K. For instance, Income-tax Officers here are seeking to raise assessments on concerns in India as agents for non-residents. Again, non-residents manufacturing goods outside India, selling them outside India to residents in India and then shipping the goods to India and forwarding documents to a Bank in India for the Bank to collect the sale proceeds on behalf of the non-residents and deliver the documents to the buyer when payment has been received are faced with the contention that this constitutes receipt of the proceeds which includes the profits in India by or on behalf of the non-residents and that therefore the whole profit is assessable in India.

There is a considerable amount of case law on this question to which the Chambers and other organisations represented on the U. P. Ad Hoc Committee would invite the Commission's attention, such as Civil Appeal No. 41 of 1952, M/s. Turner Morrison & Co. Ltd. Vs. Commissioner of Income-tax, West Bengal. These cases, and the earlier ones referred to therein, exemplify the range of commodities forming an important part of India's international trade which stands to be affected most adversely by the current interpretation of Section 42 and 43—Tea, Wool, Salt, Shellac to mention a few. With regard to the mere purchase of goods in India and other

acts which have been held to constitute operations carried out in India for profit by or on behalf of a non-resident, a charge of tax under Section 42 is a most serious deterrent to trading with India. Other countries do not admit the validity of India's claim to tax and refuse double tax relief for Indian tax suffered. At the present time this means that any profit attributed to the act of purchase suffers an overall tax burden of more than 100 per cent. where the non-resident buyer is resident, for example, in the United Kingdom, United States, Germany or Japan. A consequence of this kind will affect trade with India to an increasing extent as Section 42 is more and more diligently applied and it should not be forgotten that in recent years India has relied upon buyers in these territories to take more than 50 per cent. of her exports. The result of allowing this position to continue will inevitably be a grave restriction of trade to India's detriment in a buyer's market; overseas sellers will either refrain from trading with India or will do so only where the title in the goods and payment can be obtained outside India. It is very essential therefore that prompt steps should be taken (a) to amend the law to exempt, in the case of the non-resident who buys or sells goods in India, the manufacturing and other profits attributable to operations carried on outside India by the non-resident and (b) to exempt profits when the non-resident has not an established place of business in India.

Several of the difficulties referred to above arise because of the absence of any statutory definition of 'business connection' thus permitting a variety of interpretations by individual Income-tax Officers. This omission should be remedied it is suggested, in such a way as to ensure that non-residents may be more precisely aware of their liabilities under the Act. Based on current international practice as agreed to by most countries in recent double income-tax agreements—the negotiations of which, particularly with the United Kingdom as India's largest customer, is very essential—an explanation should be added to Section 42 providing firstly that a non-resident person shall not be deemed to have a business connection in the taxable territories unless he maintains therein a branch, management, factory or other fixed place of business; secondly that an agent in the taxable territories for a non-resident person shall not be deemed to be a business connection unless he has and habitually exercises a general authority to negotiate and conclude contracts on behalf of the non-resident or keeps a stock of merchandise from which he regularly fills orders on his behalf; thirdly, that a non-resident person shall not be deemed to have a business connection in the taxable territories merely because he conducts business dealings through a *bona fide* broker or general commission agent acting in the ordinary course of his business as such; and, fourthly, that a fixed place of business or an agency maintained by a non-resident person solely for the purchase of goods within, and the sale or conversion of these goods without, the taxable territories shall not be deemed to be a business connection.

Question 52.—What modifications would you suggest in the definition of 'agricultural income' Section 2(1) to avoid the contingency of the same income being taxed by the Central Government as well as the State Governments, e.g., in respect of income from forests, dividends from agricultural companies, etc.?

It will be necessary to change the definition of 'agricultural income' so as to exclude the portion of dividend which is proportionate to the agricultural income of agricultural companies such as tea companies. The ruling of the Bombay High Court in *Re: B. F. Guzdar Vs. C. I. T. Bombay City (XXII-ITR-158)* laying down that the entire dividend from tea companies is liable to Indian Income-tax has made certain portion of the income liable to double taxation, i.e., agricultural income-tax and Indian income-tax. Before this ruling the practice of the department was to take only a certain proportion of income from dividend as income from non-agricultural source. That position should be restored by suitably amending the definition of 'agricultural income' so as to exclude the amount proportionate to agricultural income of such companies as income derived from both agricultural and non-agricultural sources. Income from forestry has been held to be taxable in some cases and not taxable in others. It is better to define precisely whether such income should be included in the income liable to Indian Income-tax.

As a matter of fact, there is very little agricultural operation in forestry while large amounts are realised by the sale of timber. Such income should be liable to Indian Income-tax and not to agricultural income-tax. It is, however, not every year that such income is realised by the owner of forests and it would clearly be unjust if the total income realised in a certain year is made liable to tax in that year. It is, therefore, suggested that such income should be spread over a period at least five years so as to reduce the incidence of taxation on such

occasional realisations in lump sums. It may, however, be noted that our forests have very seriously been used up during the war and this has caused much soil erosion and brought about a change in the climate of certain parts of the country. As a matter of policy the growth of forests must be encouraged and for this reason it may be found necessary to exempt the income from forests altogether for atleast ten years or so.

Question 53.—Agricultural income should not be integrated with non-agricultural income for rate purposes. The method of calculating agricultural income is quite different and no Act makes any attempt whatsoever of equating the statutory income with the real income. For instance in some States only a certain fixed percentage of the income is admissible by way of deduction for collection charges and not the actual expenses. If income calculated in this manner is to be clubbed with other income it would clearly boost up the rates of tax levied by the State and Central Governments. After the abolition of Zemindary the importance of agricultural income tax has dwindled to a large extent and only big farmers will now be liable to agricultural incometax. Consequently there does not seem to be any material advantage in clubbing agricultural and non-agricultural incomes for purposes of determining rate of tax. Tea companies pay tax at maximum rate and the clubbing of agricultural income in these cases will not make any difference whatsoever.

Question 54.—The taxation of agricultural income should be left entirely with the States for their development consistent with their resources.

Question 55.—The point raised in this question has been recognised by the enactment of Section 12AA so far as literary and artistic works are concerned. It may well be extended to other works of similar nature. In building contracts the actual profit can be worked out only on completion of the work. In such cases the profit should be spread over the period taken for completing the work.

Mining industry and such other industries which require exploration and prospecting over a long period should be entitled to deduct such preliminary expenses out of the profits for 4 or 5 years or the profits realised in the first year should be spread over the period of prospecting and exploration and the amount spent in each year should be deducted out of the profits attributed to that year. Any excess of expenditure over income must be treated as a loss and carried forward to the subsequent year.

Question 56.—Recently Section 4(3) (i) has been amended so as to restrict the exemption to income from business which is carried on on behalf of a religious or charitable institution to only those cases where the business is carried on in the course of the actual carrying out of a primary purpose of the institution or the work in connection with the business is mainly carried on by the beneficiaries of the institution.

In the case of the Gadodia Charitable Trust it was held that the word 'property' includes business also. It is to neutralise the effect of this ruling that the law has been changed but the change is not in the right direction. Ours is a welfare State and the bulk of revenue derived from taxation has to go for the uplift of the society and to raise the general standard of living of our countrymen. It is the duty of the State to provide medical relief and education to all persons living in the country. If there is a charitable minded person who devotes the whole of the income from business to a charitable purposes such as starting of educational and research institutions and for that object wants to make over his prosperous business to the trustees of a charitable trust, the State should not step in for a share of the proceeds of such a business by declaring such income not exempt from tax. It is, therefore, suggested that where a trust is genuine and its objects are well-defined so as to include objects of general public utility, the income from business carried on by such a charitable trust should be clearly exempted from taxation and Section 4(3) (i) should, therefore, be suitably amended for that purpose.

Question 57.—Business profits of cooperative societies were exempted in order to encourage the cooperative movement, but now the conditions have considerably changed and those considerations need no longer be taken into account. All cooperative societies should, therefore, be taxed like Companies and the members may be allowed relief on dividends received from the societies. The entire income should be brought under assessment.

If a very good case can be made out and exception is sought to be made in respect of cooperative societies which are cooperative ventures, mutual and non-profit making in character, tax on income applicable in their cases should be 50 per cent. of what the Companies are called upon to pay.

Question 58.—Concessions given to new industrial undertakings under Section 15C should be continued further and if after allowing all depreciation allowances and 6 per cent. on capital there is a loss, such loss should be allowed to be carried forward for set-off against subsequent profits.

Question 59.—No concessional treatment is necessary except the double taxation relief. In any case the tax levied by a foreign country should be allowed as a deduction.

Question 60.—At present 1/6th of the total income subject to a maximum of Rs. 6,000 is exempt. This limit may be raised to 1/5th subject to a maximum of Rs. 10,000 in view of the low purchasing power of the money and general rise in the level of incomes. Indirectly it will benefit insurance companies which collect money from the public for financing Government and semi-Government loans.

Question 61.—There is no doubt that in the present circumstances the Department is not really assessing the business profits but also a part of the capital represented by the difference between the pre-war price of plant and machinery and the high prices prevailing at present. Another important point for consideration is that the industry should be in a position to replace the worn out plant and machinery at the prevailing high prices. If it is unable to do so the efficiency of the industry is likely to suffer to the detriment of the interest of the country as a whole. It is not the individual industry whom we are going to favour by allowing larger depreciation allowance but it is the industry as a whole which should be considered. This point has been raised in U.K. and U.S.A. also but no solution has yet been found of the problem. The economists and the accountants, however, agree that some change is essential and the re-valuation of existing assets for depreciation purposes would be ideal. As a matter of safeguard it must be laid down that such funds shall not be available for distribution amongst the shareholders as dividends.

Question 62.—Certain changes are called for in the Classification of assets for the purposes of depreciation, rates of depreciation and methods of computing allowances. These are in brief as follows:

(a) Depreciation allowances should be on the initial cost and not on the written down values, (b) Rates of depreciation as at present are adequate, (c) There have been cases where the Incometax Officers have grouped together different kinds of machinery because of their installation in one industrial unit for the purposes of depreciation allowances and have refused the modicum of depreciation allowances on each type of machinery set up. This difficulty may be obviated, if necessary by a change either in law on the point or by the Central Board of Revenue issuing definite instructions to the Incometax Officers and the public; (d) Depreciation should be admissible on residential premises and should be allowed to houseowners according to the classification of buildings. The statutory allowance of one sixth of the annual letting value must be abolished. It is recommended that Section 9 of the Incometax Act might be amended accordingly.

Question 63.—Making of depletion allowance from wasting assets is only just and equitable and it is not considered as a concession. All lump sums paid in acquiring leases of mines, etc., should be admissible at a uniform rate during the period of the lease if less than 20 years or during the period of 20 years if the period is more than 20 years. Unless this is done we are taxing a portion of the capital and not only the profits. There is no justification why such an allowance should be admissible in the case of plant and machinery and not in the case of mines, etc., acquired for a definite period on payment of lump sums. In either case the asset is wasted by the working and the allowance is called for in all cases. Apart from depletion allowance, some tax concession must be given for the development of mineral resources.

Question 64.—Provision of specific allowance for family and dependant's is strongly recommended. In the case of a Hindu Undivided family, allowance will have to be made for the family and dependants of all the members of the Hindu Undivided family. There is nothing surprising in this demand as it is only a necessary committant of an assessment on an incorporate body like the Hindu undivided family treated as one unit. Considering the high cost of living the allowance for each dependant should vary from Rs. 1,500 to Rs. 2,000.

Question 65.—This is a very important question. Truly speaking in every business the Government is a major partner. The share of the Government fictitiously goes up by the disallowance of expenditure actually incurred. Such expenditure is left to be borne by the smaller partner and damps his incentive to earn more and induces him to find out ways and means for concealing or suppressing income. The allowance should con-

sequently be liberalised. It is suggested that the following allowances should be added to the list of allowances under Section 10(2):

(i) Indispensable capital expenditure not creating tangible asset should be allowed, e.g., preliminary expenses, amount paid for goodwill, consideration for acquisition of rights, patents, royalties, development expenses, prospective expenses and price paid for assignment of leasehold land, etc. Such expenditure is wholly and exclusively laid out for the purposes of the business and have got to be written off. When benefits arising out of such capital expenditure are taxed, why should not the capital expenditure be allowed? The poor assessee is left to shoulder such capital expenditure out of the smaller share he has.

(ii) At present expenditure on Incometax Appeals is not allowed. This is absolutely unfair. Expenditure on all successful appeals must be allowed. The present tendency is that the Incometax Officer never interprets Incometax Law in favour of the assessee. They make over-assessments on flimsy grounds and drive the assessee to go in appeal. If expenditure on such appeals is not allowed the poor assessee is saddled with a burden of unjust expenditure.

(iii) Unless collusion is proved, no part of expenditure incurred on salary, wages, bonus or commission should be disallowed. The Incometax Officer is no judge of the quantum of expenditure necessary for a business.

(iv) Allowance for depreciation needs to be liberalised as suggested beforehand.

Question 66.—No. The consolidation of incometax and supertax is not favoured. The present rate structure is not at all satisfactory. It is extremely cumbersome and the computation of tax liability has become an extremely complicated affair. Rates structure should be so simple that every assessee should compute his tax liability without difficulty. The slabs are too narrow and the jump from one slab to another is too steep. The aggregate incidence of taxation adversely affects incentives to earn more or in other words incentive to produce more. The maximum tax limit should in no case exceed 0-10-0 in a rupee. The exemption slabs should be more liberal and should vary with the number of dependants an assessee has to maintain. The aggregate incidence of incometax should be confined from six pies in a rupee to 0-2-6 in a rupee and the aggregate incidence of supertax should be confined from 0-1-0 in a rupee to 0-7-6 in a rupee. It has been noticed that in several cases with the present rate of incometax and supertax the assessment of taxes often exceeds the actual income earned by an assessee because his assessment is subjected to a number of disallowance. If an assessee has to pay up a major portion of his income in the shape of taxes, he is hardly left with anything to build up reserves for ploughing back into his industry and business. The present rate structure acts adversely on industrial and commercial expansion. The rate of surcharge stands self-graduated being a percentage of the tax which is graduated, and therefore calls for no change.

Question 67.—Have you any change to suggest in the exemption limit for individuals (Rs. 4,200) and for Hindu Undivided families (Rs. 8,400)?

While relief with regard to the exemption limit should be given in respect of individuals as in the case of individuals in the U.K. for wife and children of the assessee, the initial exemption limit in the case of Hindu Undivided Families should be thrice that of the limits prescribed for individuals.

Question 68.—(a) The distinction between earned and unearned incomes for purposes of tax liability may be continued. Such a distinction is in vogue elsewhere and is generally justified on taxation principles. Earned income is supposed to represent the result of personal initiative and effort and on that basis, is considered as entitled to special encouragement.

(b) We have no particular suggestions to make in regard to the definition of earned income. The present position seems to be satisfactory.

(c) Earned income relief is limited to one fifth of the income or Rs. 4,000 whichever is less. Once the principle of earned income being eligible to a concessional rate is accepted, there is considerable force in the point of view that the relief should be extended to a larger sector. We suggest that the limit may be raised to Rs. 6,000.

Earned income relief should also be available in respect of income of a minor partner assessed in the hands of his father.

Question 69.—Cost price or market price whichever is lower is the best principle but unfortunately the Incometax Officer does not stick to it and insist on stock valuation on the basis of cost price or market price. They ignore the expression 'whichever is lower'. Such action creates trouble for the assessee as he has invariably to go up in appeal.

Question 70.—Hindu Undivided Family should not be assessed as an unit but the individual members alone should be taxed on their shares of income. Here doubling the non-taxable limit does not give adequate relief.

Question 71.—Exemption from incometax must be allowed in respect of voluntary surrenders by managing agents of the whole or a part of the managing agency commission. No question of abuse arises in such cases as the amounts surrendered become liable to tax in the hands of the company. The managed company by such a generous action of the managing agents is provided with funds for ploughing back into the industry. In lean years the loss of the managed company is curtailed by the surrender of the managing agents. No question of misuse arises in such cases either.

Question 72.—The assessee should not be asked to pay more than the higher or the highest rate of tax levied by any one country. Where such agreement is not possible, the country where the income accrues or arises, should alone be entitled to tax that income and the other country should forgo the tax on that income.

Question 73.—The exemption granted under Section 60 with respect to unrealised rent is extremely rigid and ineffective. Due to rent controls in most of the States, there are cases where the tenants neither pay the rent nor vacate the premises inspite of lengthy and costly litigation. The condition laid down in rule 38 of exemption should be liberalised so as to exclude the rent which could not be realised inspite of best efforts by the assessee. As suits are not filed every year for arrears of that year, it is improper to limit the exemption to the rent of one year.

The *bona fide* letting value should be fixed with due regard to the rent chargeable.

Statutory allowance of 1/6th for repairs is inadequate. While the rents have been fixed at pre-war rates by Rent Control Acts, the expenses on repairs have gone up considerably due to increase in wages and the price of building materials. This allowance should, therefore, be raised to 1/4th.

Another point for consideration is that some depreciation allowance should also be admissible for deduction. After all the life of every property is limited and all the more so in industrial towns like Bombay, Calcutta, Madras and Kanpur where damage is greater. There is no justification for allowing the depreciation to a shopkeeper if he owns the premises in which the shop is kept but disallow it to the owner of the premises if he happens to be a person different from the shopkeeper. If machinery is let out to a tenant, depreciation allowance on that machinery is admissible to the owner out of the rent realised from the machinery. Similarly if any business premises are let out, depreciation on the value of the building should be admissible to the houseowner but simply because the income is assessed under the head 'property' no allowance is usually made for depreciation in respect of such property. It is, therefore, suggested that an allowance of at least 2½ per cent. on the value of the property should be admissible by way of deduction on account of depreciation.

Law charges in litigation with tenants should also be an admissible deduction.

Question 74.—The present law in respect of carry forward of losses is unsatisfactory. Under Section 24 losses of one year can be set off against the income from any other source of the same year but if the loss exceeds the income from other sources in that year such excess or where there is no other source, the whole of that loss can be carried forward and set off against income from the same business in the subsequent year. There is considerable case law on the point whether the business in the subsequent year is the same business or a different business. As such there is no justification for imposing this limitation. It should be permissible to claim the loss of one year against income from any other source in the subsequent years and no liability to tax should arise unless all these losses are altogether wiped off. This point has been agitated in the Press several times and included in representations made by various business organisations not only in India but also in the U.K. Only recently the U.K. law has been changed so as to make it possible for an assessee to carry forward the loss for setting off against income from any other source of one subsequent year. The relief allowed is not full but all the same it is some improvement on the present position. Another limitation imposed by the law of U.K. is that the business in which the loss was incurred should be still running in the subsequent year. Such a limitation should not be imposed in India. Very often an assessee may find it useful to close down that business to save himself from further losses. If, in such circumstances the losing business is closed, the loss suffered in that business must be an admissible deduction from any income in subsequent years. It is clearly unjust to levy tax at the present high rates on a person who is burdened with heavy losses of preceding years simply because he happens to derive some income from investments and

other sources in subsequent years. The capacity to pay is seriously impaired and this point must be recognised in the enactment of any taxing Statute.

Question 75.—The provisions of Section 18A were introduced to curb inflation during the last War. At present money market is extremely tight and hence it is not deemed necessary that Section 18A should continue on the Statute any further. Provisions of Sections 18A and 23B are mainly responsible for the delay in making final assessments. Having realised the tax according to the returns, the Incometax Officers, allow the cases to drag on for about four years till they are forced to make the assessment by virtue of the provisions contained in Section 34. The system of advance payment of taxes should, therefore, be abolished.

Question 76.—It is suggested that the copy of the reasons recorded by the Incometax Officer and the copy of the Commissioner's sanction for the issue of notice under Section 34 should be sent to the assessee along with the notice under Section 34. This step is necessary so that the assessee may know the reasons which have prevailed upon the Incometax Officer for issue of the notice under Section 34, and thus he may get an opportunity to meet the points raised in the order of the Incometax Officer, in the course of the proceedings under this Section. Further under Section 34 clause (1) sub-clause (b), the information in the possession of the Incometax Officer must be new and on a point of fact. The word 'opinion' should, therefore, be qualified accordingly.

Question 77.—It is not so much the question of changing the law as of changing the procedure followed by the Incometax Officers. At present what happens is that Incometax Officers without care fully scrutinising the returns and copies of Profit and Loss Accounts and other papers submitted with the returns mechanically issue notices under Section 22(4) and 23(2) and start probing into matters which are already apparent from the record. Considerable time of the Incometax Officer as well as of the assessee is wasted in this manner. What is suggested here is that the Incometax Officer before issuing notice under Section 22(4) or 23(2) should carefully scrutinise the return and documents submitted with the return and jot down the points which require further elucidation from the assessee or the scrutiny of accounts. A brief note should be prepared by him describing these points and when the assessee appears with the accounts, the points raised should be cleared and the assessment should be completed in his presence so far as possible. At present without any rhyme or reason cases are postponed from day to day and there is hardly any case in which the assessee is not required to attend with his accounts for a number of times. The Incometax Officer should adjust his cause list so as to fix up only those cases which he can take up during the working hours of the day. An attempt should be made to complete the scrutiny of the accounts as far as possible on the same day. The fear of criticism by superior authorities should be eliminated altogether from the minds of the Incometax Officers as this fear alone is responsible in most cases for asking the assessee to prepare copies and notes from his account books and file them on the record. This extra burden should not be thrown on the assessee. If any useful information is required from the accounts, the Incometax Officer should be asked to take notes from these accounts. In some cases the assessee has virtually to copy out almost all his accounts for filing before the Incometax Officer. Some Incometax Officers, although they have nothing on the record against the assessee, postpone cases from day to day simply to create an impression on the minds of inspecting officers that the accounts have been thoroughly examined by them. It would be good if Section 22(2) is so amended as would require an assessee to submit a return not earlier than six months after the close of his accounting period.

Question 78.—The Appellate Tribunal should not have powers to enhance the assessment. If there is any discovery or concealment after the order has been confirmed by the Appellate Tribunal there is nothing to stop the Incometax Officer from proceeding under Section 34. The law has given ample powers to the Incometax Officer to prevent any income from escaping assessment and consequently the suggestion for conferring the power of enhancement on the Appellate Tribunal is uncalled for. Besides, the Appellate Tribunal is a judiciary body and not an assessing body. If they are allowed enhancements the fundamental principle distinguishing judicial and assessing authorities disappears.

Question 79.—The entire income of the company should not be subjected to Corporation Tax. It is suggested that the first slab of Rs. 50,000 should be exempt from Corporation Tax. This will exempt all small companies from Corporation Tax and also give the much-needed relief to bigger companies in bad years. No element of progression is necessary in the levy of Corporation Tax if the above suggestion is accepted.

Question 80.—If the recommendations made above is accepted, it would not be necessary to levy different rates of tax for different types of corporate enterprises. The holding companies should not be asked to pay Corporation Tax on income from dividends from Companies which have already been subjected to Corporation Tax.

Question 81.—The demand for exemption of inter-corporate dividends from Corporation Tax is fully justified. The present system of levying Corporation Tax on dividends in the hands of every company leads to hardship and double and treble taxation of the same income. For instance 'A' company pays dividend out of its taxed profits to 'B' company. At present the 'B' company is again asked to pay Corporation Tax on the gross amount of this dividend and if a portion of 'B' company's dividend goes to a third company 'C' that company is also asked to pay Corporation Tax on this dividend. As the rates of Corporation Tax are pretty high, the burden becomes unbearable.

It is altogether unfair in the case of holding and investment companies whose only business is to hold securities or shares in other joint stock companies. The main object of such investment companies is to even out investments and to encourage the formation of capital for investment in other industrial enterprises but this object is frustrated if such companies are made liable to Corporation Tax on profits which have already been subjected to that tax in the hands of the original company. There is already an exemption granted by the Governor-General in Council *vide* notification No. 47, dated the 9th December, 1933 under Section 60 of the Act but the tendency at present is to ignore the conditions laid down in the rule and refuse exemption on arbitrary grounds. What is suggested in the alternative is that the rule granting exemption should be incorporated in the statute and the order refusing exemption should be appealable like other orders of the Incometax Officers. It should no longer be within the executive powers of the Central Board of Revenue. The main point, however, is that in principle the double and treble taxation of inter-corporate dividends to Corporation Tax should be altogether avoided. If this is accepted the exemption conferred under Section 60 on public investment companies would become unnecessary.

Question 82.—Banks and Investment Companies should not be asked to pay Corporation Tax on income from dividends. The reserves which are compulsory according to Indian Banking Companies Act should not be subjected to Corporation Tax. In the case of Insurance Companies, the whole of the policy holders' surplus should be exempted from tax as in U.K.

Question 83.—Undistributed profits should not be liable to maximum rates of incometax. At present a rebate of 0-1-0 per rupee is allowed on undistributed profits. This concession is not adequate. This limit should be raised to 0-2-0 per rupee. The main point for allowing this concession is to encourage companies to plough back their profits into the business. It would encourage formation of capital which is an essential need of the day. Further the Government has not to pay any rebate on undistributed profits to shareholders. By way of safeguard it may be laid down that if in any future year the company draws on its reserves for distribution of profits it may be asked to say so in the certificate issues to the shareholders and in that case the rebate on the dividend may be reduced accordingly.

Private companies can easily be classified into two categories:

- (1) engaged in industrial enterprises;
- (2) engaged in commercial enterprises;

In the case of companies engaged in industrial enterprises, the need for the formation of reserves for ploughing back into the industry is as great as those of public companies and what is suggested is that before applying Section 23A to such companies, the Incometax Officer should take into account not only the loss incurred in earlier years or the smallness of the profits made by the Company as at present laid down in Section 23A, but he should also consider the sums ploughed back into the industry by renovation of building, plant or machinery or by other capital expenditure incurred in the interest of the business. In such cases Section 23A should not be applied as in fact due to such expenditure it will not be possible for the company to distribute a larger dividend. The expansion of the business will ultimately lead to greater profits which would be automatically liable to tax yielding larger revenue to the State. In the case of commercial concerns the limit of 60 per cent. should be reduced to 40 per cent.

Question 84.—It is indeed unfair that dividends distributed by a company should again be charged to super-tax in the hands of the shareholder. It was not felt at the time when the rate of Corporation Tax was not more than 0-1-0 per rupee but this rate has been going up in the interest of revenue considerations and has been taking away an appreciable portion of the profits by denying the company either the distribution of dividends or the

building up of its reserves. The Corporation Tax should also be deemed to have been paid by a Company on behalf of its shareholders and credit for the same should be allowed to the shareholders in their personal assessments.

Question 85.—Industrial, commercial and similar other enterprises undertaken by the Centre, States and Local Bodies should be subjected to tax exactly in the same manner as limited companies.

Question 86.—What is needed is an improvement in the morals of the people as a whole. Resort to methods such as the publication of names of defaulters and the imposition of any obligation of the type envisaged in the question on the assessee is not favoured. If the fruitful employment of recognised professional men such as Chartered Accountants as a means to minimise the work of the Incometax Officers is sought, the form of Certificate must be prescribed and once a certificate on the prescribed form was obtained, the same must be honoured without its being subject to a suspicious examination by the Incometax Officer. The matter of fees for the issue of certificate must be left to be settled by the clients and the Chartered Accountants without extraneous interference.

Question 87.—No further amendment to Section 61 is necessary. The present system of representation of assessee appears to be satisfactory.

Question 88.—What is needed is an improvement in the morals of the people as a whole. Resort to methods such as the publication of names of defaulters and the so-called public disgrace of delinquents hardly serve any purpose, if the fundamentals of character are lacking. These ill considered *Ad Hoc* measures go only to blunt feelings against the so-called crime of tax evasion and rather encourage people in its indulgence after the first default. The whole matter needs a statesmanlike attention rather than a narrow policeman's outlook.

Question 89.—No, the perquisites given to employees of business undertakings do not result in considerable loss of revenue. As a matter of fact Incometax Officers have already started enquiries into the perquisites and have started including such portion as they consider to be excessive which is not justified.

Question 90.—Powers possessed by Incometax Officers are sufficiently wide and no fresh steps seem to be necessary for safeguarding payment of tax dues from companies under liquidation. All the same it is suggested that as soon as a company decides to go into liquidation it should intimate fact to the Incometax Officer and place all its accounts for the period which has not been subjected to incometax. It would enable the Incometax Officer to determine the taxable income and the tax due from the company. This amount can be intimated to the Liquidator and the Incometax Officer should stand *pari passu* with all unsecured creditors.

Question 91.—This question of conferring powers to search premises and seize documents and books of accounts on Incometax authorities has been before the public for quite a long time. It has been opposed tooth and nail by the public and representatives of trade associations and business communities. Such a step, it is feared, will simply embitter the relations between the assessee and the Department. It will increase abuses and corruption in the Department. There are not many countries which have conferred such powers on the Incometax authorities. Evasion of avoidance of tax will not be prevented by conferment of such powers. The best method of checking avoidance is public propaganda so that a tax-dodger is not held in esteem by the public. Training of Incometax Officers for extending courtesy towards assessee is also very essential. The present method of behaving like police officers and discrediting every statement of an assessee even on minor points creates a very bad impression on the minds of even honest assessee. In short, mere powers of search will not minimise evasion and avoidance of tax but will lead to harassment and defamation of assessee and abuse and corruption of the Department. What is wanted is that the assessee should feel that it is his duty to contribute to the public revenue according to his income and every Incometax Officer should feel that besides collecting the revenue he also acts as a Judge between the assessee and the State. He should develop precisely a judicial frame of mind and should not so behave as to create an impression that he is out to collect revenue by fair means or foul.

Question 92.—No precaution seems to be necessary to prevent the creation of an artificial legal entity. The Incometax Officer has very wide powers not to recognise a firm which is not a genuine partnership. The formation of a company makes the profits liable to Corporation Tax which would otherwise not be attracted. There is nothing like a family partnership. The status of a Hindu Undivided Family with respect to the business or the property which forms the subject of partnership must be

shaped before a partnership is formed. This introduces very important changes in the character of the ownership of that property and to suggest that it is only for reducing the rate of tax that this practice is resorted to will be altogether incorrect. Where a family is dissolved and the members including the minors agree to carry on the business in partnership, such firms should be recognised by the Department and the practice of Incometax Officers viewing such partnership with suspicion should be discouraged.

Question 93.—It would not be just to recover the unrealised tax of any partner from the firm or to make the other partners liable for it. It would clearly be unjust if without a warning a firm is asked to bear the burden of tax payable by an ex-partner. The bogey of unrealised tax from partners of a registered firm is not quite intelligible in the face of provisions of advance payment of tax under Section 18A and provisional assessment under Section 23(B). It may, however, be pointed out that difficulty in realising the tax arises by very late assessments sometimes four or five years after the end of the accounting period which is to be assessed. During this long period considerable changes in the fortunes of the taxpayers are likely and some of the partners may become untraceable. It is, therefore, suggested that the Incometax Department should be made more efficient so as to dispose off assessments as far as possible within the year to which they relate.

Question 94.—Yes, the present arrangements relating to recovery of incometax are adequate. Instead of tightening the machinery for recovery proceedings, the existing provisions therefor should be liberalised. Over assessment and consequential heavy demand often dislocate the economy of assessee and impairs his capacity to earn. In any case taxes in respect of disputed income under appeal must be stayed pending the final disposal of the appeal.

Question 95.—Placing of tax liability upon the shareholders of a private limited company in proportion to their shareholdings is not favoured. This cuts at the very root of the principle of formation of companies. Cases of non-payment of incometax by private companies have not reached such a stage as to justify taking of such a drastic step.

Question 96.—No. The property should be assessed in the name of its rightful owner only. The question whether the ostensible owner is the rightful owner can be decided only by a civil court and the Incometax Department is not competent to decide it.

Question 97.—Relations between the Incometax Officer and the assessee can never improve so long as the Incometax Officer considers himself to be a machine for collecting taxes by fair or foul means. The entire outlook of the Incometax Officer needs to be changed. Seldom an Incometax Officer has been found interpreting an issue in favour of the assessee. On the contrary, he will twist his assessment and import surmises and conjectures to build up a case against the assessee. He would not grant extension of time to an assessee though he may himself put off the case to suit his own convenience. To make an assessment according to returns is probably held by the Incometax Officer to be below his dignity and below his efficiency. To enhance the income returned is taken to be a measure of efficiency and the Budget Phobia during the months of February and March make the Incometax Officers wild. They do not adjust their work. They drag on cases right upto February and March and then make arbitrary assessments. Budget Phobia is responsible for all the obnoxious and defective assessments. The Incometax Officer should have nothing to do with the amount of taxes that have to be collected.

Question 98.—(i) The present system of issuing notices under Section 22(2) is defective in principle. Notices should not be issued to any assessee carrying on business unless and until six months have expired from the close of the financial year. It will create a fair distribution of work.

(iii) Penalties should not be levied as a matter of routine. It should not be treated merely as an additional tax. Penal provisions should be invoked only where it is established that the assessee's intention was to conceal his income.

(v) There has been considerable agitation on the question of administrative control over Appellate Assistant Commissioners. Even the Select Committee on the Incometax (Amendment) Bill, 1952 was very sharply divided on this point but the Government seems to be adamant and has put forward one excuse or the other which leaves the public unconvinced. What is wanted is that the Government should take courage in both hands and effect the much-needed reform which would go a long way in improving the relations between the assessee and the Department. The present arrangements create grave doubts in the minds of the assessee as they seem

to get no relief on important points from the Appellate Assistant Commissioner. Some people would prefer to take their appeals direct to the Appellate Tribunal and leave out the Appellate Assistant Commissioner altogether, as the decision by the Appellate Assistant Commissioner simply prejudices the assessee's case and reduces his chances of getting a fair deal even at the hands of the Appellate Tribunal.

Question 99.—There is no doubt that undue delay occurs in the course of assessment proceedings. This is simply due to suspicion in the minds of the Incometax Officers and also a sense of fear of criticism by the Inspecting Officers. There is absolutely no justification for either. The feeling of suspicion can be dispensed with if the Incometax authorities realise that they have very wide powers in reopening assessments if any definite information comes into their possession of any concealment even after the assessment of a particular year has been completed. The feeling of fear in the minds of Incometax Officers can be removed if the Inspecting Officers are helpful in their criticism and make only constructive suggestions. The personal likes and dislikes against officers should be altogether eliminated. Formation of groups, parties and factions among officers should be discouraged.

As already pointed in the answers to the foregoing questions, the provisions of Sections 18A and 23(B) are mainly responsible for undue delay in the course of assessment proceedings.

Question 100.—Only special circumstances such as war would justify the levy of Excess Profits Tax or Special Business Taxes

Question 101.—In framing the Estate Duty Bill the provisions of U.K. Act have been borrowed word by word. It needs modification on the lines brought out in the report of some of the members of the Select Committee. In this connection, the following suggestions are worth considering:

- That minimum taxable estate considering the present value of the currency should not be below Rs. 1,50,000.
- That rates should be as low as possible in the beginning.
- Clause 80 sub-clause (2) of the Bill should be dropped altogether else it would give a death blow to dealings in shares in the Stock Exchanges.
- Absolute gifts to public charities should be recognised whenever made and not only those made more than six months before death.

Question 102.—There should be no differentiation in the matter of rates chargeable on self-acquired property and property forming the estate of a deceased. Not only its working would lead to considerable complications but in some cases it may be found almost impossible to decide which portion of the property left by the deceased was inherited and which was self-acquired.

Additional points in respects of Taxes on Income (Part II of the questionnaire) which the drafting sub-committee recommend for adoption by the U. P. Ad Hoc committee on Taxation.

1. Clearance of arrears of incometax assessments and cases with special reference to rebates and refunds.

In view of the enforcement of provisions contained in Sections 18A and 23B of the Indian Incometax Act in respect of advance payment of tax and provisional assessment respectively, final assessments are not disposed of till they are about to become time barred. After a lapse of four or five years an assessee is put to considerable inconvenience and at times in impossible situations if he is asked to explain and lead evidence on points raised by the Incometax Department. Assessments made at that late stage in this context do not make it possible for the assessee to find either the money or to face the avoidable embarrassments. Litigation then ensues to the detriment of all concerned and with undesirable consequences following.

There are a number of cases of banks and insurance companies under which losses have been incurred but tax has been deducted on dividends and interest on securities. The Department is generally tardy in disposing of such cases and the assessee is deprived of considerable sums due to them as refunds. There is no reason why such assessments should be kept pending in view of the provisions contained in Section 34 with regard to incomes escaping assessment and concealments could be appropriately dealt with when discovered. In fact pendency of assessments over a long time will only be found leading to inefficiency all-round. Assessments must be made and completed in the same year to which they relate and carryovers must be an exception rather than a rule.

It is common knowledge that money conditions are hard in so far as industry and business are concerned. With the development of buyers' market everywhere, conditions have hardened further. If much relief cannot be extended in the field of taxation, industry and business should at least be freed from adverse consequences arising out of arrears in assessments. Speedy clearance of arrears of incometax cases with special reference to rebates and refunds will go a long way in freeing them from worries and industrial and business ventures can look forward to economic rehabilitation.

2. Avoidance of unnecessary litigation between the assessee on the one part and the Central Board of Revenue and the Incometax Department on the other through appropriate liaison and assessee contact work.

On an analysis of the litigations on Incometax matters, it will be found that most of these litigations are avoidable and unnecessary. The attitude in general should be for the assessee and the Central Board of Revenue and the Incometax Department to settle affairs of taxation without going to Courts and the forum of law.

It has been found that a particular decision on a point by the High Court favourable to the assessee in respect of a particular assessment year is not invoked for application for the subsequent assessments too though these assessments after going through the High Court through all processes involved will be conditioned by the same decision or order. It is realised that the Department does not enjoy the power to alter the decisions of Appellate Tribunal in this context and the application of decisions may not, therefore, be possible in certain cases. The Act may be amended suitably to meet such ends also. Tribute Trust Privy Council Decision 1939 (VII I.T.R. 415) arising out of assessments to incometax form 1933-34 to 1938-39 were made. The assessee applied to the Commissioner of Income Tax to cancel the assessment in view of Privy Council Decision but the Commissioner of Incometax refused. The High Court intervened and declared the assessments a nullity (12 I.T.R. 370). This order was upset by the Privy Council (XVI I.T.R. 214) which held that the assessments were not a nullity. The result was that the assessee had to pay six years tax which was not at all due as the Trust income was exempt under Section 4(3) (i) of the Incometax Act. The Incometax Investigation Commission took a serious view of the matter and recommended change in Law vide Pages 126 and 127 para. 281 of the Report.

It is recommended that special liaison officers for public relations work may be appointed with headquarters at convenient centres such as Bombay, Calcutta, Madras, Kanpur and Ahmedabad, etc. These public relations officers must be drawn from judicial cadre and must be independent of the Central Board of Revenue in order to be able to inspire confidence all-round. The assessee in cases of differences between them and the Central Board of Revenue and the Incometax Department may approach these Liaison Officers who shall make a note of the assessee's cases and get matters settled as they ought to be without the assessee having to go to Courts of Law and expensive litigation. This step will also improve assessee—Department relationship considerably and help in quick and better collection of taxes.

POINTS NOT COVERED ABOVE.

The attention of the Chamber has been drawn to circular No. 8 (XXI-3), dated the 10th April, 1953 issued by the Central Board of Revenue in which it is laid down that a shareholder of a company should not obtain credit for the tax paid by the company on dividends, if the shares are not registered in the name of the assessee. This instruction would prove hard in the case of persons who borrow money from the banks for the purchase of shares and the banks by way of additional security get these shares transferred in their names. In such cases there is no intention of avoidance of tax. The Banks do not declare the income from these dividends in their own returns and give credit for the dividend to the real owner. In such cases certificates from the banks should be considered sufficient and the condition of the shares being registered in the name of the assessee should be waived. Such a step is absolutely essential in the interest of the banking business. It is not only when advances are made that banks get shares transferred to their names but many times banks hold shares as nominees or trustees or executors also.

2. Cases have been referred to the Chamber where Incometax Officers have attributed the profits of the firms to persons who are not the partners of the firm without even giving them an opportunity to say something in their defence. Such a procedure is against all canons of law and must be looked down upon by the higher authorities. Unless a sense of fairness and justice is developed in the Inspecting Officers and crooked ways of over-zealous and incompetent officers are not seriously taken notice of there would not be much improvement in the Department.

PART III.—COMMODITY TAXES (CENTRAL AND STATE)

CUSTOMS

IMPORT DUTIES.

Question 103.

Within the general structure of Indian Custom Tariff simple additions and alterations could be made from time to time to make certain entries more intelligible to merchants and to bring it in line with the changing pattern of trade. Since the present Indian Customs Tariff has been the work of experts and the same has come into use and understanding tolerably well no change can be proposed in the general structure thereof. Correlation of the Indian Customs Tariff with the Import Trade Control Schedule, though desirable, does not appear possible of achievement from the results evident from the efforts made so far. In fact the quotation of terms from the Import Trade Control to Customs authorities with reference to doubts on similar entries in the Indian Customs Tariff has not been found to carry the contestant any far. In the case of a local jute mill which recently imported some parts made of wood to it in their spinning plant as a part thereof under the sanction of Import Control Authorities as per entry in the Import Trade Control Schedule the customs authorities at the first two stages rejected the Import Trade Control specification to treat it as wood and to subject it to a much higher rate of customs duty. In another case the import of shoddy woollen blankets from Italy met with the same fate. When in the interior cases of this type come to the notice of the Chamber such instances must be pretty large in port towns. It is, therefore, evident that a revision in nomenclature and in units of measurement and weight in respect of items in the Indian Customs Tariff is called for. This being a technical matter it is suggested that such changes as are to be made in the Indian Customs Tariff from time to time must be consigned to an Expert Committee composed of experts in Customs matters, standardisation and industries.

Question 104.

(i) Raw materials as are not at all available in India but are in use in industries already established here must bear almost no duty while the products of the industry so treated, when imported as manufactured goods from outside, should be subject to a heavy import duty. If there are prospects for new industries and they cannot be established because of the high cost of raw materials and capital goods and from the enquiries of Tariff Commission it is confirmed that there are fair prospects for such industries to thrive. Import Duties on articles in use by that industry which have to be imported must be governed by the same considerations as stipulated above. These stipulations are more important and they should be implemented without loss of time in respect of the industries whose products can pave the way for the exploitation of export markets.

(ii) This is a matter for Tariff Commission to decide from time to time.

(iii) Reduction in import duties to counter smuggling will amount to sacrificing national interests for the sake of criminals. Stringent measures of dealing with those detected of smuggling and honest and vigilant customs personnel can only be depended upon to keep the evil at its minimum.

(iv) & (v) No comments.

Question 105.

The relative use of *ad valorem* and specific duties in the Indian Customs Tariff is satisfactory.

Question 106.

(i) When price fluctuations are not violent tariff values offer themselves as satisfactory bases for the assessment of import duties.

(ii) No comments.

(iii) The existing procedure for determining tariff values must be considered satisfactory. The Chamber will, however, impress upon the Commission the need for a more close and effective consultation with the industries and trades concerned before the determination of tariff values.

Question 107.

Real value as defined and provided for in Section 30 of the Sea Customs Act need not be altered in view of its importance and implications. There are enough powers vested in the Customs Authorities to deal with mal practices, frauds and dumping and undervaluation.

Question 108.

In addition to the suggestions made in Answer to Question 104, materials used for scientific research either by Government or by recognised industries and industrial Associations should be free from import duties.

Materials imported for charitable purposes might be extended the concession of rebate substantially depending upon the charity. But materials imported for humanitarian purposes if proved to the satisfaction of customs authorities and Government should be free from import duties. Articles in category 4 and 5 in the question need not be given any exemption.

Question 109.

The Fiscal Commission when considering this question had touched upon the implications of General Agreement on Trade and Tariff on revenue. Subsequent events have also justified the Fiscal Commission's views on the matter. These agreements do not seem to have affected revenue from import duties in any appreciable manner. Hence revenue point of view need not be given importance in deciding upon Trade Agreements.

Question 110.

Whenever protection is sought to be extended to indigenous industries and enterprise customs duties offer themselves for a better use than import control. No hard and fast rule can be laid. Both quotas and high tariffs might have to be used in case of helping any indigenous enterprise. This is a matter for enquiry by the Tariff Commission from time to time.

Question 111.

The Sea Customs (Amendment) Bill, 1953 fully meets the need for assisting export trade in manufactured goods which involve the use of imported raw materials and therefore the Chamber has no recommendations to make.

Question 112.

No comments.

EXPORT DUTIES.

Question 113.

Whenever there are disparities between the internal and international prices of an exportable item, the former being low as compared to the latter, whenever there is a need for depressing internal prices of commodities for serving internal markets and wherever the commodities that we export are monopoly items without any competition in international markets, export duties could be levied in the interest of the Exchequer.

Question 114.

The Export Advisory Council should constitute a small Sub-Committee of theirs to review changing conditions in the export markets and to recommend adjustments in export duty from time to time. More than anything else quick action is called for in making adjustments or imposing export duties.

Question 115.

No comments.

Question 116.

The Chamber is totally opposed to the participation by the State in import and export trade. Apart from the adverse repercussions any such participation will have in the general economy of the country overall revenue considerations of Government should alone discourage such participation.

CENTRAL EXCISE

Question 117.

In terms of conditions that generally apply to the imposition of excise duties and from the point of view of the opinion expressed by the Taxation Enquiry Committee 1924-25, we must regard the present selection of commodities for the levy of excise duties as satisfactory. To the extent these duties make the price structure of the commodities rigid, they should be considered unsatisfactory in the context of buyers' resistance developing in respect of a commodity in mass use.

Question 118.

(i) In so far as the present rates of excise duty on vegetable oils and cloth appear to press heavily upon the poor, a reduction in the rates of duty may be considered.

(ii) No comments.

Question 119.

No comments.

Question 120.

No comments.

Question 121.

The present arrangements for the assessment and collection of excise in respect of manufactured commodities cannot be characterised as very satisfactory. In the first place serious objection is taken to the insistence on the part of excise authorities in factories having to provide residential accommodation for the excise staff and provision to that effect in the Manual. There

is no correlation between the Excise Inspectors' ideas of the release of goods and the transport made available by authorities. Payments of extras to the excise staff even within law to avail transport placed at the disposal of the factory on the plea of work beyond office hours and on holidays are clearly unjust to the factory having to pay such charges as also the tax. Stock checking and the maintenance of stock card in warehouses and the rules made towards that end are cumbersome and entail the taxpayer, i.e., the factory management to considerable trouble.

Question 122.

The proceeds from excises should go towards revenue. The practice of earmarking a portion of the proceeds of excise for development or for improvement of some other form of cottage industrial effort in the same line is deprecated.

Question 123.

No comments.

SALT DUTY.

Question 124.

Please see answer to Question 35. Yes. Salt duty must be reimposed. Production and imports must be totally in the hands of Government, the duty becoming payable at the point of distribution at sources for sale.

PART III.—COMMODITY TAXES (CENTRAL AND STATE).

Question 125.

Services should not be covered by the taxation on the sale and purchase of goods because this is a commodity tax and not a professional or service tax. Wherever the element of services are mixed up with goods and where these two can be distinctly separated, goods involved may be subject to taxation, leaving the services element free from taxation. In hotel bill, etc., where services and goods cannot be readily separated, there should obviously be no sales tax. Such categories of trade will be few and far between and will not play, anywhere in India, any significant part in sales or purchase tax revenue collections.

Transactions on the sale or purchase in stock exchanges and future markets should not be subjected to any taxation on purchase and sale because they do not constitute sale or purchase in terms of the usual definition of 'sales' (Budh Prakash Jai Prakash vs. Salestax Officer, Kanpur, *vide* 1952, III Vol. STC, page 185). Future markets are intended to act as regulators of commodity market price trends, keeping under check violent fluctuations in ready markets and the business therein does not constitute a business in commodity as such. Therefore anything concerned with commodity taxation must have nothing to do with future markets.

Question 126.

Any tax levied on newspapers will be in the nature of taxing knowledge and education. Newspaper business in India as elsewhere, is not a profitable business in the nature of any other business operation, at least in its initial stages and for years and calls for tremendous initial sacrifice. Circulation of any newspaper accounts for only a fraction of the revenue in newspaper business, advertisements being resorted to in order to make good as much of the current expenditure as possible. These considerations apart, when it is realised that the incidence of salestax on newspaper sales and advertisements cannot be passed on in view of the small price of newspapers and space sales for advertisements cannot bear tax, applicability of salestax mechanism to the sales of newspapers becomes almost impossible. Under these circumstances it is recommended that no tax either on sale of newspapers or on advertisements should be levied and the power conferred on the Union Government in this respect must not be invoked for quite a length of time to come.

When sales and purchases of commodities are taxed, anything done to encourage such sales and purchases by way of services such as advertisements, public relations, market research, etc., should not be taxed. The element of these services will be found added to the price of the commodity which will become the basis of tax.

Question 127.

Sales or purchases taxes cannot be ever replaced by the extension of excises, octroi and terminal taxes and customs. Excises carry with them the elements of protection or restriction on consumption, as the case may be, besides revenue considerations. When an industry requires protection and the consumption tax is also required from the produce of that industry in the interest of revenues, the necessary amount of excise would be unobjectionable only when it is accompanied by import duty equal to the excise duty together with protective duty. Sales or purchases taxes are not taxes on production hemmed in by the above limitations and

that therefore with the extension of the principles of excise, excise duties cannot be made to replace sales or purchases taxes; even in respect of goods manufactured or produced within the State. The levy of octroi and terminal charges to finance local bodies is considered primitive and as offending all accepted canons of taxation. The avoidable complexities and confusion created and the scope it offers for fraud and evasion cannot ever give it the status of a State Taxation. How then can this principle be extended to replace salestax on goods transported into any State from elsewhere in the country? Customs duties all over the world have distinct roles allotted to them in every country's foreign trade, each country being taken as one whole. Factors such as protection, monopoly, international markets and prices, competition, balance of trade and payments etc. are the determinants of custom duties either on imports or on exports. Sales and purchases of commodities within the State have barely anything to do with the above factors. The determinants mentioned above do not have anything to do with sales and purchases. A State does not directly import goods from abroad just as U. P. does not. How can goods imported into the country be apportioned to States on any acceptable basis? Under these circumstances by extending the principles of customs to salestax, sales tax cannot be replaced by customs in respect of goods imported into any State from abroad. Salestax has a specific function to perform as a distinct tax on trade on the State level and it cannot be replaced by the extension and that hotchpotch mixture of customs, excises and octroi and terminal taxes.

Question 128.

(a) Yes.

The criterion of individual sale price as distinguished from aggregate turnover cannot form the basis of sales tax in the context of conditions obtainable in India. That is the precise reason why a purchase tax on the lines of the U. K. Purchase Tax cannot be imposed and levied with success in India. Aggregate turnover must be the only guide for a considerable length of time to come in India for the assessment in each case of sales tax.

(b) There should be separate law of salestax in every State on a uniform basis in respect of all articles which are subject to central excise duties on the lines of such laws at present in force in some States governing sales tax on petrol. The administrative aspect of the problem should be examined and sales tax levied must reach the State where articles are consumed irrespective of who collects it where.

Question 129.

(1) In any system of levy based on turnover, the choice is limited only to the three alternatives mentioned in the question excepting that under single point mechanism under (ii) the registrations can also be dispensed with, the tax levies being confined to the points of sales by either a manufacturer or an importer as is the case in U. P. Transmission tax as in Belgium or Purchase tax as in the U. K. cannot be thought of in the context of turnover as they depend on invoicing and sale prices in respect of every individual item.

(2) The mechanism of taxation on turnover as provided for under (i) of the question 129(1) relating to singlepoint tax is preferable to any other alternative because the ultimate consumers of goods and service can alone be made to pay the taxes by a single shifting of the incidence of taxation on the last leg of the disposal of any commodity. Multi point, besides throwing ultimately a heavy burden on consumers, tends to eliminate several processes involved in the distributive trade, thus sapping services and creating unemployment. Any combination of the first two alternative tends to make legislation in respect of sales tax complicated and leads to widespread discontent and charge against legislature, Government and the tax administration of being partial either to this or that commodity or to this or that class of dealers. Single point system is practically in vogue in U. P. whereunder the points at which taxes are levied are the sales by either the manufacturers or the importers that is at the first leg of the series of sales in the process of disposal and not at the point of sales to the actual consumer of the commodities subject to tax. This system has been found casting avoidable burden on productive activities and manufacturers besides giving place to anomalies such as the impossibility of securing exemption even on legitimate exports out of the State because the exporter happens to be a dealer other than the manufacturer. The producers are called upon to bear the burden of this tax on almost all their purchases used in the process of manufacture or production and also pay taxes on the sale by them of their manufactured goods. The system of single point tax as it is in vogue in U. P. is, therefore, not desirable. This system of taxing under single point mechanism the first leg of the disposal of a commodity, i.e., at the

point of sale by manufacturer or importer is workable and good when everywhere in India, there is a sellers' market in respect of any conceivable goods. In buyers' markets the burden falls inequitably on those that produce or serve distribution.

It must be realised that since multiple turnover tax system takes full effect at every stage of production and trade, it has a strong cumulative effect. It engenders unequal competition between multiple and non-integrated businesses. This principal feature alone calls for confused legislation and rules and orders conceived almost arbitrarily to rectify the position. It also involves more than necessary powers being vested in Government to notify from time to time exemptions, tax limits, etc., etc.

In the single point system, under competitive conditions of trading while the structure and costs of distribution may stand affected, the non-cumulative effect of the tax will not handicap any particular business and discriminate against integrated and non-integrated businesses. The consumers are supposed to bear the burden which will be relatively smaller on the whole under this system though the tax quantum might be greater as compared to multiple point system. Under single point, articles of mass consumption and necessities including raw materials for industries being subjected to *de facto* or *de jure* exemptions inherent in the system itself, luxuries and articles finally entering into consumption may be made to carry a greater load of taxation thus imparting to the system an elasticity denied under multiple point system. In salestax, if properly administered, there should not be any appreciable evasion. By its very nature and due to the fact that an assessee's pocket is not touched and that he merely acts as tax collector for Government, stringent provisions are not necessary. Simplicity of procedure, facilities for compliance, regard for the cost of the maintenance of machinery for collection of and accounting for taxes and an administration charged with honesty and understanding should be capable of keeping evasion at its minimum.

Single point system as enunciated in question 129(1) (ii) offers scope in most of these respects as against any other system of turnover tax. In fact multiple point tax leads to the discovery of ingenious methods for evasion and also results in actual evasions owing to the dictates of business exigencies under competitive conditions.

Question 130.

(1) Yes. Articles of luxury and class use must be loaded with higher burden than articles of necessity and comfort.

(2) Yes. Raw materials and commodities awaiting processing before disposal, even if acquired by a non-registered dealer, must be available tax free.

(3) Water foodgrains, and cereals, oilseeds, medicines, medicinal preparations and drugs, packing materials, books and stationery in use by students and educational institutions, *gur*, condiments, sweets and food sold by *halwais* and hotels, grey and unbleached cloth under certain counts should uniformly enjoy exemption all over India. The sales of all such articles as are deemed necessary to keep alive and clothes mass of the people to a minimum standard should be exempted from taxation because of the poverty of the masses that use them.

Question 131.

In the system of salestax rates, exemption, etc., there should be uniformity all over India notwithstanding the argument that living conditions vary from State to State. It is not desirable to bring sales tax as a whole in the Union List exclusively because of the States enjoying only one major source of tax revenue, which is flexible in character and which can be fashioned according to the needs and economic development of the State concerned. We will advocate the attainment of uniform conditions through constitutional amendments so as to include certain basic matters connected with salestax in the Concurrent List. Rates of sales tax and exemption lists must be as far as possible uniform all over India.

Question 132.

No uniformity has been achieved in regard to exemptions obviously because of non-adherence to one principle governing exemptions and the relaxation that Presidential Order and Parliament's prescriptions give to privileges enjoyed by the States in this matter before 1950. (President's Order No. C. O. 7, dated the 26th January, 1950.) Provisions in clause 3 of Article 286 of the Constitution of India must be extended to all articles which public opinion and Parliament consider as essential to the life of the community all over India whether or not such article or articles had been subject to salestax before the relevant control enactment came into force.

Question 133.

In the light of the findings of the Supreme Court in respect of Article 286(1) and 286(2) of the Constitution of India in the famous Bombay case, the Bihar Government have called upon parties in Bombay State to pay tax on their sales to parties in Bihar. The U. P. Government have similarly called upon parties in Bombay to pay tax on their sales to parties in U. P. though the delivery by the sale of goods had been completed in every sense of that term in the State of Bombay. Many more surprises are in store and assessments dating back to 1950-51 may be taken up now according to the best judgement of assessing officers, for the service of demand notice on parties outside the State's territorial jurisdiction. Cases may crop up in which purchases of goods made by a party outside U. P. after the payment of tax in the purchasing State and brought into U. P. for consumption or use may be brought within the ambit of the U. P. Salestax Act by a literal application of the pronouncement cited above and tax may be demanded of the party that sold or supplied goods in question outside U. P. without any knowledge of its consumption or of the party purchasing them. Bihar Government have served notices on such U. P. dealers as had supplied goods to Bihar parties to get themselves registered under the Bihar Sales Tax Act if the parties desire exemption of their sales on dealer to dealer basis from sales tax under the single point tax mechanism in vogue there. Registration in U. P. under Section 8 of the Act is quite a different matter. It typically concedes power to pass the incidence of the tax on the parties to whom goods are sold on either single point basis or multiple point basis of taxation and to turn over such collections to U. P. Government. Any dealer in any part of India having the off-chance or prospect of supplying goods even once to any U. P. party should, therefore, get himself registered under the U. P. Act if he chooses to pass the incidence of U. P. Salestax on to his purchaser. Variety of complications are thus bound to arise in the future. The limits as to turnover being what they are, where are bound to be several lakhs of assessees to salestax all over India each one or whom has got to deal in each case with no less than eighteen State Governments and each of these State Governments with as many as several lakhs of assessees all over India. This single factor alone is bound to create administrative problem of insoluble nature for every State Government besides rendering business of manufacture and supply of goods somewhat parochial in character in the wake of initial confusion.

While the pronouncements of the Lordships of the Supreme Court in respect of Article 286(1)(a), Explanation attached to the above Article, Articles 286(2) and 304 all read with Articles 246(3) and List II of the Seventh Schedule of the Constitution of India will very likely throw up somewhat confusing and difficult problems at the outset, it has nevertheless to be borne in mind that the principle of territorial nexus underlying the salestax laws of the different States leading to the multiple taxation of the same transaction by different States and the cumulation of burden falling ultimately on the consuming public has been set at naught by this authoritative interpretation of the Supreme Court. This advantage may be found far outweighing the irksomeness and initial difficulties of the dealers having to deal with different State Governments and *vice versa*.

We think that the Commission should go into this question in all its perspective and keeping in view the essential ingredients of the transactions being subject to tax only once in one State, should examine the possibility for minimum changes in the relevant provisions of the Constitution to obtain the desired ends in view. In the meanwhile, in order to obviate administrative difficulties arising out of implementing the provisions contained in any Sales Tax Act with regard to sales made outside or stock of goods having entered the State in question for consumption there, and to avoid the confusion of having to call dealers outside the taxing state to comply with the provisions of the Acts the desirability of every Salestax Act of every State containing provisions on the line of Section 18 of the Bombay Sales Tax Act with suitable modifications as acceptable to each State may be examined.

Question 134.

Yes. See the answer to Question 133.

PART III.—COMMODITY TAXES (CENTRAL AND STATE)

STATE EXCISES

Question 135.

(a) Please see answer to Question No. 35.

Prohibition, partial or total, specially in respect of alcoholic liquors has been of doubtful benefit and success. While this policy of prohibition has occasioned losses to the tune of about Rs. 30 crores to two of the eighteen States of India, the actual loss to all the States which

in some form or the other relinquished this revenue and the loss of the potential possibilities for revenue would be considerable. U. P. Government have admitted that their prohibition has almost been a failure. Cases in other States cannot be any better. Illicit distillation and bootlegging have become common features in most places. In spite of the heavy expenditure on the enforcement of prohibition the availability of liquor has not lessened. One requires only the money to buy it. Something beyond the quantum of what would have been the excise duty goes to the pocket of the racketeer. Corruption and crime is encouraged more by prohibition than by the drink evil. Further when it is realised that this excise is to secure prevention in consumption as far as possible, only way open is to raise the excise duty to make consumption of alcoholic liquor or drugs prohibitive. At a time when development expenditure calls for the utilisation of every possible resource it is not wise to go by sentimental dictates and the illusion of securing social reform.

(b) In so far as the Constitution of India permits the Centre to levy excises on toilet and medicinal preparations, there should be uniformity all over India, in the levy of excise on alcohol and rectified spirit used in these preparations. The States may, however, collect and utilise these duties. This should be achieved through Central Legislation in this respect by Parliament.

GENERAL

Question 136.

Except in the case of export duties no case can be made out for vesting in the administration the power to alter by executive order any rates of any duties. Even in the case of export duties, changes in rates by executive order should be effected at the Cabinet and Presidential levels and the same must be confirmed by Parliament when it meets after the change had been effected.

Question 137.

Commodity taxation does not offer any field for extension in the present circumstances. Five Year Plan if it really secures the standard it promises should be able to account for better returns from the existing fields of commodity taxation.

Question 138.

No comments.

PART IV.—AGRICULTURE INCOMETAX, LAND REVENUE AND IRRIGATION RATES AGRICULTURE INCOMETAX

Question 139 & 140.

There has no doubt been a vast shift of income towards agriculture sector for the last ten years consequent upon a much greater proportion of increase in agricultural prices than in the prices of manufactured commodities. With direct taxation such as land revenue and agricultural incometax, the latter wherever they have been introduced, not having yielded to expansion as taxes on income in sectors other than agricultural all these years, the incidence of tax in the agricultural sector has been much lighter than in other sectors. When it is realised that the percentage of consumption of the articles bearing customs duties and sales tax in the agricultural sector is almost negligibly small, it is evident on the whole that the contribution of agricultural sector by way of tax revenues in India is totally inequitable. Schemes of development under the Five-Year Plan and a major share of total investments therein relate, and very rightly too, to the agricultural sector. Canalisation of income to those that can neither save nor invest in the above circumstance does not appear sound. It is in this context that all taxation measures in this sector have to be viewed. Agricultural incometax, wherever they are imposed at present, are not likely to account for any elastic and progressive income to the States concerned owing to Land Reforms, Zemindari Abolition, a tendency towards the fixation of ceilings to agricultural holdings, land gift movement, the outlook for a recession in agricultural prices, difficulties inherent in the calculation of determining agricultural income owing to the absence of accounting and banking habits in the agricultural sector and the mass of agriculturists falling below the minimum taxable limits. The experience of working up this tax system has been only of three to five years in almost all cases and that too confined to only four or five States in India and sufficient data is not available on which to base the future plans in respect of this taxation measure. Since this tax in respect of its assessment and collection is nearer to land revenue than to the Central Taxes on Income and the machinery constituted for it, the question of Centre taking over the assessment and collection of this tax on behalf of States does not appear either desirable or feasible. This apart when it is considered that there is no uniformity either in systems of agriculture and agri-

cultural produce or in the prices and disposals of agricultural produce all over India, it becomes extremely difficult to think of treating agricultural incometax ever as a subject for the Concurrent List, powers being taken by the Centre to determine the rates of levy and assessments and collections. The nature of agriculture incomes are quite different from other incomes and any co-ordination cannot therefore be possible though one can be correlated to the other. Yet the need for a single co-ordinating authority to assess taxable income from whatever source agricultural or otherwise cannot be over-emphasised. Land Revenue which touches the agricultural sector more extensively than any other tax in that domain will be found to have some basic considerations in all States common to agricultural incometax also. From this point of view too, it will be found undesirable to centralise or semi-centralise this measure of taxation. Informal approach on the part of Centre appears to be the only way out. The U. P. Agricultural Incometax Act, U. P. Act III of 1949 as amended up to date appears to offer some solution to the difficulties enumerated. All the States in India should be asked to expedite legislation on that model with variations to suit local conditions and Agricultural Incometax should be in operation all over India. The Central Ministry of Agriculture & Food should constitute a Central Price Board to correlate and co-ordinate the Agricultural costing and pricing methods in the different States of India and should in due course evolve formulae applicable to the determination of net agricultural income in respect of every state in India. Agricultural Incometax Legislations may take into consideration such formulae. Non-agricultural income should be taxed as at present by the Centre and a liaison must be established between the Incometax machinery and Land Revenue machinery in States to help each other in avoiding evasion.

Question 141.

With the exemption limit for agricultural incometax at Rs. 3,000 net income, it can be expected that the illiterate villager or a small holder will not come within the purview of the Agricultural Incometax Act and that those liable to this taxation are capable of accounting for their income and expenditure. Though there may be no accounts habit in rural areas, the determination of certain major trends in agricultural revenue and costs should not be altogether impossible for application to those that have no accounts at all of their operations. In cases where accounts are not kept and produced before the assessing authorities the income may be deemed to be such multiple of the rent of land determined for land revenue purposes as fit in with the local economic conditions of the State concerned and the general nature of crop produced, e.g., commercial crops, food crops or a combination of both. Provision has, however, to be made for exemptions in case of natural calamities such as failure of crops, etc. In calculating exemption for calamities possible variations from normal crop and the translation of the same in terms of area sown and reaped should be the basis. It has, however, to be borne in mind 'no loss' years are exceptional and rare and that, therefore, only that loss which is in excess of normal loss should be considered. In cases where returns are duly filled in and accounts are maintained and submitted, the gross value of the crops in terms of sale price may be arrived at and from it may be deducted all amounts actually paid by the assessee (a) ploughing and hoeing, (b) sowing including the cost of seed, (c) weeding, (d) watering and irrigation, (e) harvesting and thrashing of crops, (f) making the crop fit for market, (g) transport charges (in case bullock carts and other transport medium are maintained for this purpose the cost of maintenance thereof plus depreciation charges), (h) manuring and the cost of manure actually purchased, (i) customary charges paid in cash or kind to artisans for service on land, tanks, walls, agricultural implements, etc., (j) depreciation on equipment and agricultural implements at a reasonable percentage not exceeding 10 per cent. for their capital value, (k) depreciation on livestock used in agriculture and transport not exceeding 20 per cent. of gross investments therein, (l) depreciation on the means of irrigation, walls, building, etc., not exceeding 5 per cent. of their capital value, (m) land revenue and local rates paid in the preceding year, (n) crop insurance premia paid if any, (o) rent and other irrigation dues paid specially to secure means for agriculture in the land concerned, (p) interest on borrowings, if any, if such borrowings had been spent exclusively on land and land improvement and interest on mortgages, if any, arising out of the land ownership and exploitation.

Exemption for calamities may be given in this case also as indicated earlier.

Wherever both the above ways of determining taxable income for agricultural incometax purposes are found inapplicable after thorough enquiry and for valid and understandable reasons, 50 per cent. of the gross value of the crop as represented by the market price thereof when it gets ready for disposal may be allowed

s deduction to determine the net income for assessment and in doing so loss arising out of calamities might also be considered.

Question 142

The following rate of Agricultural Incometax are suggested for adoption by all States in India on a uniform basis.

The following rates are subject to the conditions that :

- (a) no agricultural incometax shall be payable on a total agricultural income which does not exceed Rs. 3,000, and
- (b) the agricultural incometax payable shall in no case exceed half the amount by which the total agricultural income exceeds Rs. 3,000.

In the case of every individual, Hindu undivided family, Muslim waqf, firm and other association of individuals, not being a Company, the basic rates of agricultural incometax may be as follows:—

	Rate
1. On the first Rs. 1,500 of total agricultural income	Nil.
2. On the next Rs. 3,500	One anna in the rupee.
3. On the next Rs. 10,000	One and a half anna in rupee.
4. On the next Rs. 10,000	Three annas in the rupee.
5. On the balance	Four annas in the rupee.

In the case of a company, agricultural incometax shall be payable on the whole of the agricultural income at the maximum rate of four annas in the rupee.

In the case of every individual, Hindu undivided family, Muslim Waqf, firm and other association of persons not being a company the basic rates of agricultural super tax shall be as follows :

	Rate
1. On the first Rs. 25,000 of total income	Nil.
2. On the next Rs. 10,000	One anna in the rupee.
3. On the next Rs. 10,000	One and a half anna in rupee.
4. On the next Rs. 10,000	Two annas in the rupee.
5. On the next Rs. 10,000	Two and a half annas in rupee.
6. On the next Rs. 10,000	Three annas in the rupee.
7. On the next Rs. 15,000	Three and a half annas in rupee.
8. On the next Rs. 15,000	Four annas in the rupee.
9. On the next Rs. 15,000	Four and a half annas in rupee.
10. On the next Rs. 30,000	Five annas in the rupee.
11. On the balance	Five and a quarter annas in the rupee.

In the case of an association of persons being a co-operative society for the time being registered under the Co-operative Societies Act, 1912, or under an Act of the Provincial Legislature governing the registration of Co-operative Societies :

	Rate
On the first Rs. 25,000 of total agricultural income	Nil.
On the balance	Two annas in the rupee.

In the case of every company:

On the whole of total agricultural income Two annas in the rupee.

A convention has to be developed through persuasion by the Centre in this respect. Constitutional changes to secure uniformity in rates are not recommended.

LAND REVENUE & LAND CESSES

Question 143

Yes. In the absence of reliable data regarding agricultural crop production and prices and also owing to the lack of accounting habits in the village communities, the more reliable system of basing land revenue on net produce has to be abandoned in favour of periodical settlements whereas variety of misleading factors are forced to be taken into consideration. The

period of settlement varies from 10 years to 40 years in the different States of India. This long spell of time between settlements are intended to secure for the agriculturist the advantages arising out of better prices in the period and permanence and a sense of security with regard to his returns and obligations. If we take the rise in prices of agricultural commodities during the last ten years and the settlement operations once in 40 years as in U. P. together we will find that much that has been legitimately due to the U. P.'s Exchequer from the agricultural sector had been lost and in its place other sectors had to be squeezed. Nevertheless the present system of land revenue in India can be cited as hardly recognising the limit of taxable capacity and satisfying any of the canons of taxation.

Question 144

There is no other alternative but to depend upon land revenue on the basis of periodical settlements. Period of guarantee should not be more than 10 years and should be uniform all over India without legislative pressure from the centre. A fixed assessment based on wholesale prices of crops usually grown in the area for the last ten years on a weighted basis and yields thereof and guaranteed for a specific piece of land would be better than the fixation of basic rate with variations. Abnormal depression in agricultural prices and booms therein may be covered by remissions and surcharges determined on the basis of set principles. Land revenue should not be depended upon to provide incentives to production and shifts in production. Natural economic trends must be allowed to determine shifts in agricultural production. Incentives to production must be provided by economic prosperity and accelerated demand for agricultural produce both internally and from outside India. Assessments of small holdings of land below the standard minimum for revenue demand may be on the basis of payment in kind with permission to commute such dues into cash at any given time. But this facility must be limited and allowed only in exceptional cases under exceptional circumstances.

Question 145

Annual value must form the basis of resettlement. This value should be the gross produce less cost of production including the value of labour spent by the farmer and his family on the holdings concerned. Certain principles must be arrived at after a thorough enquiry into the agrarian economy in each state and these principles must come up for uniform application in every State in respect of this matter

Question 146

Surcharge on old rates based on crops grown, size of holdings and the wholesale prices of those crops in well definable regions appears to be the only alternative enforceable to bring old rates into conformity with changed conditions wherever resettlement is overdue but cannot be completed for administrative or other reasons. Certain amount of disparity is bound to crop up but the same could be corrected by the basis recommended for the determination of the surcharge.

Question 147

See answer to Question 146. No further comments.

Question 148

From the experience of Zamindari Abolition in U. P. whereunder the old tenant-occupier has now become the owner of the land will pay Land Revenue which the Zamindar was paying on that land to Government direct and has acquired the ownership by paying ten times the annual land revenue in lump sum wherewith to pay and compensate the Zemindar, it appears possible to visualise tentative arrangements pending the completion of survey and records and the consequent assessment.

Question 149

No. Co-operative farming need not be given any special performance in the matter of land revenue when other facilities are available for exploitation by Co-operative Societies protracted very much under law.

Question 150

No comments.

Question 151

If agricultural land in rural areas is used for non-agricultural purposes such land cannot obviously be assessed on the usual basis for land revenue. It has to be reassessed with reference to the use to which such a land is sought to be put and the principle of 'what the traffic can bear' should be brought into application. Land classed as agricultural but now part of an urban area must be assessed and leased out as *Nazul* lands in U. P. are assessed and rented out. The revenue from this source should be solely Municipal. Land classed as non-agricultural whether in rural areas or in urban areas and used for non-agricultural purposes must be

subject to property taxation in vogue in the area and the revenues, therefrom should belong to the local body concerned.

Question 152

No comments.

Question 153

See answers to Question 189 to 194 and 200 in Part VI of the Questionnaire.

Question 154

Land cess should be a certain percentage or expression in terms of annas to a rupee of the annual rent value of land. The rates should be flat and no graduation thereof is recommended for adoption at present. These cesses must be assessed and collected by the Land Revenue collection machinery and made over to the respective local bodies from whose jurisdiction such collections are made. These cesses should be earmarked for building and maintaining roads and communications.

IRRIGATION RATES & BETTERMENT LEVY

Question 155

People who benefit from the improvement in land through irrigation or other projects must be made to pay a fair share of such improvement by carrying the burden over a number of years. Though the entire cost of any such development project cannot and should not be expected from the immediate beneficiaries and the general tax payers has to bear a portion of the burden, it should be possible for the immediate beneficiary to pay the interest charges on capital outlay and maintenance expenditure on such development works. Since water alone cannot increase the productivity of soil and full advantage of development and water supply can be taken only with additional investment of capital and since with the provision of water, the land values in the area move up, it will be in the fitness of things if a small compulsory cess for all lands under command in the developed area whether the water is actually utilised or not as a general betterment tax is levied this cess being a small fraction of land revenue realised in that area or block. In addition, the irrigation rate for water actually supplied may be charged from owners of lands where such water is used. This betterment levy should, however, be earmarked for irrigation development and must not be taken over to general revenues.

Question 156

Twentyfive percentum to forty percentum of increment in land value consequent upon development and irrigation may be absorbed by the State as betterment levy. The percentum of such levy will depend upon the needs of the State and general economic considerations obtainable there. The annual rental value of land on which land revenue has been leased may be roughly taken as 3 per cent. of the cost of land and the original value of land may thus be arrived at. Its market or saleable value after improvement had been effected might be determined by expert valuation after taking into consideration crops grown, increased productivity of land, prevalent prices of such crops, prospects for further acceleration in production etc. From the latter might be deducted the former and this will be the total increment in the land values in that area or block. Canal Department must be made responsible for the collection of this levy with the co-operation of land revenue collecting agencies. This levy must be spread over a sufficiently long period for realisations in case the property is not marketed or sold after improvement has been effected and betterment levy assessed. In the case of sale or disposal otherwise but not on transfer by legal succession, the entire betterment tax due must be collected from the seller making the buyer also responsible for payment should the seller fail to clear the dues. It will not be improper and it should not be impracticable to impose and levy betterment rates on lands already benefited by an existing irrigation work. Probably some exceptions might have to be made in this case in respect of sales at higher values having already been effected before betterment levies are imposed. The levy in this case must be earmarked for development purposes and must not go to general revenues.

Question 157

(i) Irrigation rates should be no more than an adequate charge for water supplied in the context of proposals contained in answers to Questions 155 and 156.

(ii) Area irrigated and quantity of water supplied should form the bases for irrigation rates.

(iii) Water rates must be revised periodically with special reference to the cost of maintenance of works and interest charges over every five years.

Question 158

See answers already given.

Question 159

In proportion to the advantages offered by mine work or a tube well scheme betterment levy irrigation rates and irrigation cost should be capable of being adjusted and consolidated into one whole as a surcharge on land revenue.

Question 160

Please see answer to Question 159.

Question 161

No comments.

PART V.—OTHER TAXES (CENTRAL & STATE).

Stamp Duties and Court Fees

Question 162 & 163

Stamp duties are in the nature of taxation though for the most part they relate to the conferment of legal rights on documents thus imparting to such duties, the character of a specific service and function. The incidence of this tax falls mostly on persons who are parties to transactions relating to considerations of value. Within certain limitations, therefore, these duties may be levied on *ad valorem* basis. Stamp duties should not, however, be so excessive as to retard business and to tempt persons who ought to pay them in their own interests, to resort to evasion, both legal and illegal. The powers enjoyed by the Centre in the Union of India under our Constitution to fix the rates of Stamp Duties in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts clearly show the tacit admission of the fact that the stamp duty should not only be uniform in respect of rates all over India but also be covered by a single pattern of administrative thereof. Stamp duties are one of the most convenient methods of raising revenue through taxation though their potentials are limited and it is this factor alone that outweighs the general disinclination of economists to justify this tax. Conferment of powers on the State to fix the rates of stamp duties in respect of most of the transactions not covered by the Central List was found presumably necessary to enable the States to meet the varying needs of revenue and the economic conditions thereof and to mutually reconcile both these factors in the determination of the rates of stamp duties. Nevertheless this arrangement of the division of powers and responsibilities for the determination of stamp duties between the Centre and the States and of the placement of revenue from stamp duties in the Concurrent List in the Seventh Schedule of the Constitution causes considerable inconvenience and hardship to everyone who has an instrument to execute under law in one State in respect of things or matters in another State where the Stamp Duty is lower in one State and higher in the other. Similar difficulties will be found to arise where the instrument to be stamped covers properties and for things done or to be done in two or more States all over India. It is, therefore, suggested that all stamp duties other than judicial as covered by the Indian Court Fees Act should be a subject matter for legislation by the Parliament for the whole of India in so far as the fixation of rates and the collection of revenue through Stamp Duties are concerned. The revenue should go to the States and not the Centre. Paragraph 282 in the Report of the Indian Taxation Enquiry Committee 1924-25 (Todhunter Committee) detail out the general principles that should govern the fixation of the rates of Stamp Duties as follows:—(i) the point at which the value of the convenience or utility attaching to the use of a particular type of document or the resort to a particular kind of transaction approaches the amount of stamp duty involved, (ii) the point of diminishing returns (in other words, what the traffic will bear), (iii) the point at which hardship on any class of the community is involved. These principles will be found apt for application in India even to-day. Since revenue from 'Stamps: Non-judicial' does not form a significant proportion of revenue from stamp duties in almost all the States and since 'Stamp duties' levied under the Indian Stamp Act should not be stretched to correct even partially monetary maladjustments, the central station of this duty in so far as it relates to non-judicial items will secure more advantages than occasion any real loss of revenue. The present rates of stamp duties on items on the Central List should be retained without alteration for the whole of India. Schedule 1A inserted in the Stamp Act by Section 12 of the U. I. Act III of 1936 may be considered satisfactory in the light of the present revenue needs of almost all the States in India and may be incorporated in the Indian Stamp Act Schedule I for application all over India. In view of the fact that most transfers of shares and

ocks are effected under a system of blank transfers and the legitimate duty is thus avoided and that this system of blank transfer cannot be done away with in respect of the dealings in stocks and shares, it may be provided that every contract covering every transaction

the Stock Exchanges shall be duly stamped on a uniform basis all over India and in this the active operation of the Stock Exchange Authorities might be sought. This should not prove difficult in the context of the Commission on Futures' Markets having come to existence to regulate in India, the futures' markets on a rational basis. Excepting stock exchange transactions or transactions otherwise also through genuine transfers of shares, stocks and securities, all transactions in futures including specific delivery contracts could be subjected to salestax (turnover tax) on the basis of a consolidated rate per centum of turnover and the co-operation of the regulated futures' exchanges must be sought in this respect. It is hoped that with the strict enforcement of regulations governing the conduct of forward and futures' markets in India under the aegis of the relevant Commission these Kerb transactions or street gambling in futures will cease and even if they exist they will do so under the risk of penalty for gambling. Stamp duties cannot and in principle should not be applied to transactions in futures markets excepting Stock Exchanges. In the above context the operation of one single stamp Act for the whole of India (and not one Courts' Fees Act for India) should not be considered as not feasible.

Question 164

No. Salestax based on turnover is not a transmission tax based on invoices as in Belgium. It is neither a purchase tax again based on invoices as in the U. K. and as long as accounts only figure in the determination of the turnover and not a type of document, the process of collecting revenue through stamps cannot be enforced. Since entertainments are based on tickets of admission to the places of entertainment, the Stamp Act easily becomes applicable here.

Question 165

Underestimating the value of considerations involved in conveyances and other transfers of property, the substitute use of Promissory Notes and Bills of Exchange for Bonds, the advantage taken of lower duty by treating a settlement as gift, wilful undervaluation of property for the purposes of deeds of partition and Blank Transfers in transactions relating to stocks and shares and securities are some of the most common methods of evasion of Stamp Duties in India. The use of powers already vested in official machinery with discretion and the refusal of Courts to admit as evidence understamped documents will mitigate evasion to a considerable extent. Review of duties from time to time on the general principles outlined in Answer to Questions 162 and 163 and the fixation of rates so low as to make evasion unremunerative but the yield of overall revenues progressively better is another method of tackling the evasion of stamp duties. The provisions of Indian Stamp Act as adopted by the different States are still unknown even among the educated. The judicious execution of provision contained in Section 78 of the Indian Stamp Act (Act II of 1899) might go a long way in this direction. Evasion arising out of ignorance can thus be avoided.

Question 166

Court Fees are different from Stamp Duties in that Court Fees cannot be treated as a tax, general revenue considerations having any bearing on them. The guiding principle of Court Fees is the special payment for a specific service of special reckoning in each case between the authorities and the contributors. The revenue from and the consequent levy of Court Fees must, therefore, depend upon the cost of service in providing for the administration of Courts, justice and attachments thereto such as jails and police involved in that process. The cost of providing judicial machinery in any State will appear to depend upon the areas, population, economic set-up and the potentials for and latent economic activity including the State of Education and standard of living. These conditions vary from State to State very markedly and the differences in the rates of Court Fees are, therefore, bound to exist. We do not, therefore, advocate uniformity in respect of this matter.

Question 167

Answer to this question will depend upon the effective judicial reforms that are being attempted in the country both at the Central and States' levels. In relation to the expenses involved in litigation, Court Fees at the moment as in U. P. do not appear to cast unduly heavy burden. The change in the Schedule is, however, a technical matter to be considered by persons qualified to speak on Court practice and procedure with special reference to accounting processes involved in litigation and related documentations. Schedules to the

Indian Court Fees Act are, however, old having been modified from time to time by every State to suit peculiar conveniences and it, may be said that the same require recasting. Debates in the Legislative Council, Uttar Pradesh in May 1938 when Court Fee Act was being amended throw some light on this question and the arguments advanced in the course of that debate are therefore, not repeated here.

Taxes on Motor and Other Vehicles :

Question 168

It is clear from the Report of the Motor Vehicle Taxation Enquiry Committee, 1950 that the State expenditure on roads in almost every case far outweighs taxes collected from Motor Vehicles and that increasing reliance is placed on Motor Vehicle Taxation by the States as a set-off against their expenditures on roads. Conditions vary from State to State in respect of road communications and use in the context of areas and population. The largest numbers of motor vehicles on road in Bombay and West Bengal States and for its size in the Delhi State do not reflect either the extensive use of roads by such vehicles in those States or the proportionate size in road expenditure consequent upon such road use. The cities of Calcutta, Bombay and Delhi all of which under no circumstances can be characterised as merely State cities made rich and prosperous by the States' resources, will be found to account for most of that number of motor vehicles in use in those States. All such taxation that hinders trade indirectly such as terminal taxes and taxes on passengers and goods carried by motor vehicles should, however, be scrapped if road transport is meant to be encouraged and helped. It is also necessary to aim at uniformity and not centralised collection of State Motor Fuel taxes and the Salestax on motor spirit. Though it may not be possible for Casting the motor vehicles tax into one pattern and size for all the States of India, the aim should be to gradually bring about uniformity in motor vehicles tax. A consolidated tax on motor vehicles does not appear feasible.

Question 169

Motor Vehicles Taxation should not be considered as fees and the implications involved in the levy of fees, the principal among which is that the cost of service must have some bearing on the overall levy, should not be involved in respect of Motor Vehicles Taxation. The recommendations of the Motor Vehicles Taxation Enquiry Committee, which in effect seek to earmark revenues from Motor Vehicles and motor spirit almost in its entirety to road maintenance, judged in the above light, are not as tempting as they would have otherwise been. Any watertight bottling of revenue resources specifically for a purpose might rob the purpose itself of its ability to attract necessary funds. In fact road development and maintenance should depend upon the general economic prosperity which they will generate and all the users of roads must be made to carry the burden of road taxes more equitably than now. The tendency to earmark revenue from Motor Vehicles for road maintenance and development will thus be found self defeating.

Question 170

While agreeing with most of the recommendations of the Motor Vehicles Taxation Enquiry Committee subject to the remarks under Questions 169 and 170, centralised collection of States motor fuel tax and the elimination of salestax on petrol are not considered feasible. The recommendation that with the levy of transport cess as a surcharge on fuel tax the price of motor fuel should be equalised all over India is particularly supported.

Question 171

All users of roads should be subject to taxation according to their economic circumstances and the use they make of the roads without exception of even the cultivators. A small cess or surcharge on land revenue to cover cultivators' carts and State taxation of all bullock carts and other vehicles using roads other than strictly municipal ones are measures that can go to impose equitable burden of taxation for the use of roads on all concerned. Collections from these sources may be made over after deducting collection expenses to the District Boards for the development and maintenance of roads under their jurisdictions.

Entertainment Tax

Question 172

The plea of the Cinematograph Industry Enquiry Committee regarding the incidence of tax falling heavily on the industry cannot be considered as valid. If a scientific investigation of business trends during the periods of depression is carried out and the results are analytically considered industry or tradewise, it will be found that cinema trade and industry keep-on pushing

ahead with concentration in urban areas with evil social effects all the same. It is not to the entertainment tax that depression or stagnation in cinematograph industry and trade could be traced and temporary set backs in cinema industry and trade should not be mistaken for the operation of diminishing returns consequent upon entertainment tax.

The present system of graduated realisation of entertainments tax in U. P. appears to be satisfactory.

Question 173

Educational films having reference to the spread of desirable knowledge among masses and not intended for top classes only and when receipts are sought to be fully applied without remunerating the participants in any show beyond actual expenses to charities approved by Government in writing prior to the show should only figure for exemptions.

Question 174

Though the evasion of entertainment tax cannot be shown to involve State treasuries to any substantial loss of revenue and as helping evaders with any appreciable advantage over those that obey law in this respect and pay the taxes because of the urban character of this tax, it will all the same be found necessary to put an end to this evil of evasion. Evasions mostly occur through complimentary admissions to the places of entertainment without tickets. Entertainments having the character of religious affiliations to them also get confined to classes with restrictive admission, club functions having the characteristic of exclusiveness about them and confined to members but which are nevertheless entertainments are other instances of evasion. These are necessary evils and cannot be altogether avoided. The system in vogue in smaller towns generally and in some bigger centres also of the places of entertainment such as cinemas, circus exhibitions, theatres etc. being treated as places for the free admission of local police and civil officials by virtue of their official positions as a matter of right must be ended before the public mind can be diverted from the evasion of entertainment taxes. All collection of entertainment taxes must as far as possible be by stamps affixed to tickets and complimentary passes or invitations.

Question 175

Licensing of those that hold street shows such as jugglers etc. by the State Government through local bodies and treating such receipts as entertainment tax receipts are recommended. Admissions to exhibitions and amusement parks and the participation in amusement diversions provided in exhibitions and parks unless they are strictly for children could be covered by the entertainments tax.

Tax on the consumption or sale of Electricity :

Question 176 to 180

Any tax on the consumption or sale of electricity is not a good tax and it is not desirable to impose the same. A tax on electric power used by industries, large or small, will be a tax on production making the cost structure rigid to that extent. Electricity is almost a necessity in urban areas and any tax thereon even on domestic consumption will amount to taxing a necessity and the already overtaxed urban resident. Electricity used in agriculture should not be touched for obvious reasons and in the present context of our developing economy. In fact our constant aim should be to generate electric power most economically and to supply the same as extensively as possible almost at cost. In fact the principle behind licensing electric supply undertakings that are privately managed and run, the fixation by public authorities of their rates of supply, limitations in their profits and the constant endeavour to compel them to reduce rates of supply are all based on this main consideration. The increasing pressure for all public utilities specially electric generating and supply undertakings being owned by the State has for its objective the complete elimination of profit motive from such enterprises. All these huge projects undertaken by the State in the Five Year Plan lose all their meaning and significance in the context of tax on electricity. Even the consideration of electricity undertakings contributing something towards general revenues by way of surplus earnings should not, in the economic interest of the community, prevail. Under these circumstances this tax cannot be considered either suitable or just. This Chamber is strongly opposed to the levy of any tax on electricity put to industrial and agricultural uses however necessary it may be to augment the resources of the Treasury.

Betting and Prize : Competition taxes

Question 181

While horse racing may be allowed to continue and flourish, participation therein must be made beyond

the reach of the average man by a heavy load of taxation not only on the admission to the place of races but also on bettings in totos and bookmakers' booths. All manner of betting on horse racing outside the race course anywhere should be, if detected, severely dealt with under law and treated as gambling. That is the only way in which evasion here can be avoided.

Question 182

Betting must not be extended any further and the extension of betting tax is, therefore, out of consideration.

Question 183

Prize competitions such as crossword puzzles, call for a more rigorous control and not only every entry should be taxed but the prizes distributed should also be subject to tax. These competitions should be duly licensed by the State Governments and their conduct governed by legislations and prescribed rules almost uniform in nature all over India. All the entries to the competition and decision of prize winners should be subjected to the scrutiny of the taxing authority and the public. Unlicensed or *ad hoc* competition should be severely dealt with under law as gambling and public deceit.

Question 184

Please see a separate Memorandum prepared by the Chamber on the subject of cesses and other taxes not covered by the Questionnaire.

PART VI.—LOCAL TAXATION

Question 185

The system of local taxation in India cannot be considered unsatisfactory in the present context of our development. It is difficult to agree with the contention of the Local Finance Enquiry Committee as raised in paragraph 83 of the Report thereof that the financial resources of the local bodies are inadequate. In support of the above contention the Committee rely on figures of *per capita* contribution and the incidence of taxation on rural income without considering whether or not existing powers given under existing statutory arrangements to raise the necessary revenue has been judiciously and fully utilised. Civic consciousness and advanced sense of responsibility, which are conspicuous by their absence almost everywhere, are called for in the community in respect of its imposing high taxation on itself for the common needs. Unconditional extensions of grants-in-aid have been to a certain extent at the bottom of such a complacent outlook. Instead of tracing the inadequacy, if any, to our own inefficiency and lack of civic consciousness, blame is at once thrown on the Constitution and devolution. The need for improvement is, therefore, confined to matters of relative detail and administrative adjustments. It cannot be seriously argued in the present state of our development and administrative equipment that there is no need for control by the State Governments over Local Self-Government authorities in the matter of taxation and budgeting. Financial resources for local bodies must increasingly come out of continuously developing areas over which they have jurisdiction in order to account for a progressive economic improvement. Unless all the existing avenues permitted by our Constitution and Statutes are fully tapped and appropriately used and the fact thereafter demonstrated that the resources are inadequate to account for improvement in a comparable way or according to a determined target, it cannot be held that the system of local taxation is in any way unsatisfactory.

Question 186

The recommendation of the Local Finance Enquiry Committee that terminal taxes on goods or passengers carried by Rail way, sea or air should be transferred from the Union List to the State List in the interest of the devolution of powers ultimately on local bodies to provide them with an additional resource of finance cannot be supported as the said Committee do not appear to have given this matter the consideration it deserved before it made this recommendation. This levy is in the first place an abnoxious one on the trade and commerce of the country. It is, therefore, only reasonable that the Union Government which regulates Industries and Commerce within and without should be the sole judge as to whether this abnoxious interference with the free flow of Commerce and Trade should at all be permitted. Secondly this tax will be found touching the administration of railways, shipping and airways which are all under the control and jurisdiction and mostly under the management of the Union Government, State Governments or Local Bodies cannot be relied upon to take all factors into consideration in permitting or disallowing these levies. This Chamber's negotiations with the Railway Administrations concerned and the Railway Board on behalf of the Kanpur Municipal Board in respect of the collection of this tax

when the Railway administrations concerned washed their hands off this matter fully brought out the inadvisability of entrusting this source of taxation to either the State Government or to local bodies through them. Thirdly the scope this tax offers for corruption unless centrally managed and collected at source by the Centre is so wide that the very vitals of civic consciousness and responsibility are sapped by the poison it generates. Hence the transference of this item to the State List is not warranted. With the savings provided for in the Constitution in respect of the continuance of such levies if they existed prior to the date of the enforcement of the Constitution and the obligation imposed on the Centre to hand over the proceeds of this tax to the States concerned, no serious objection can be taken to this entry in the Union List. Only under grave emergency and that too in unavoidable circumstances, this provision should be invoked with the help of the good offices of the State Government and the Centre must be asked to sanction levy and all this only for a limited period.

Question 187

The presence of the element of payment for services rendered in a more conspicuous manner characterises local taxation all over the world. The tax demanded in the case of local bodies must, therefore, bear a close relation to the services which that local body seeks to render to the population within its jurisdiction. What may be an inescapable need in the case of a particular group of people in a particular locality, may prove to be a luxury to the other group in other locality and the capacity and inclination to pay for the same type of services in respect of both such localities may violently differ. Further the cost of a service may be smaller in one locality as compared to the cost of the same service in another locality. In the event of the need of the same service in both the localities, one will be called upon to pay more than the other by way of tax contributions for the same service. The state of economy of the locality, the potentials it has for progress, the contribution that the services rendered by the local bodies towards the progressive improvement in the economy of the locality and the extent of consciousness in community welfare and civic obligations should be the basis for the determination of local taxation. Judged in the above light the functions of city corporation may be found to cover services, both extensively and intensively, that touch the life of almost every citizen in its varied aspects and have a bearing on the economy and prosperity of the Corporation area as a whole. The provision of water, electricity, gas, transport and such other services either by the Corporation itself as Municipalised services or through other private agencies and the maintenance of these services in continuity and efficient state may be earmarked as the responsibility of the Corporation. These services could under certain circumstances be made paying propositions in that their net contribution to the revenues of the Corporation may be appreciable and such as to keep the need for taxation at the lowest possible levels. These services must, however, be made to pay their own way by those using them and taxes ought not to be used either for the provision of these services or for their maintenance. These civic amenities are in addition to the provision of basic and elementary civic needs such as roads, sanitation and health, parks and places of amusements, education etc., which are common for almost all local bodies. The amenities and services provided by the City Corporation are so varied and all-embracing that it caters to almost every needs of citizens within its jurisdiction. These amenities and services have a direct bearing on the economy of this locality covered by the Corporation and the productivity of the population thereof. Though in relation to the sum total of amenities and services and their values, the expenses may not be considered high, the *per capita* contribution of the citizens towards these services must figure higher than that of any other type of local body. The facts that such contribution are correlated to the earnings (the average earning of the person living in a Corporation Area is far higher than that of a person living in other areas, and productivity of the residents of the area covered by the Corporation and that the amenities and services provided for are conducive to such earnings and productivity cannot be lost sight of. The taxes or fees permissible for levy and the discretion extended to the Corporation in the matter of taxation need not and should not be extended to Municipalities which cater to the needs of a population in different economic set up and size and whose contributions cannot be of the same order as those of the Corporation. In the state of economic progress we are in and the need for almost everything that goes to make the fundamentals of living necessary, our Local Boards and Village Panchayats have yet to battle with the provision of limited amenities such as wells and village sanitation, primary education, local markets, local roads, etc. to the extent of making rural areas economic and productive conscious. These bodies, cannot, therefore, be

thought of in terms of Municipalities or Corporations. Just as Municipalities and Corporations pay their way these bodies must pay their way for the most part through contribution from local resources. Their resources cannot be elastic unless their economic progress is such as to impart elasticity to the sources to their revenue. The proportion of non-tax revenue to total revenues ought to be greatest in the case of Corporation, lesser in the case of Municipal Boards and Town areas and almost nothing for the present in the case of District Boards and Village Panchayats, the last named bodies being obliged to depend upon meagre resources of tax revenue for the present.

Question 188

The framework of local taxation in most of the States in India is defective in that while the initiative in regard to the proposals for taxation for the most part lies with the local bodies the power of sanctioning such proposals lies with the State Government and that in this process of taxing the responsibility gets blurred. While there should be an around control by the State Government over local bodies including City Corporations and power in the State Government to levy taxes allocated to and capable of being imposed by local bodies in the event of the failure of the latter to act with a reasonable measure of success being inherent in such an around control, all local bodies should have independent powers of taxation subject to the minimum and maximum limits in each case to be prescribed by State Legislation. The absence at the moment of this feature in Uttar Pradesh accounts considerably for the dilapidated finances of local bodies.

Question 189

Encroachments, which may be considered too many and beyond the capacity to bear, have been made in respect of taxation, direct and indirect, by the States and Central Governments with the result that not only persons but also commodities are called upon to bear burdens beyond reasonable limits dictated by the current economy of the country. These superior authorities are also extremely jealous of the exercise of any of their powers by any local authority. It is more often never realised that the requirements of a metropolitan city area, like Kanpur for instance, can, not always be met by strict adherence to the field which is indicated for municipal authorities to raise money from and that the contribution of such a metropolitan city area to the States and Central revenues by way of taxes alone is a sizeable fraction thereof. Under abnormal circumstances as the ones under which a city like Kanpur might be shown to be placed, devolution of a fraction of indirect taxes like the sales-tax and direct taxes like the income tax temporarily and for sometime upon a local body like the Kanpur City Corporation (yet to come into being) will indeed be found helpful. Devolution of entertainment taxes upon Municipal Boards in general, of the surcharges on stamp duties and Estate Duties and Agricultural Income-tax upon District Boards and Village Panchayats are instances of taxes raised in this question.

Question 190

The levy of octroi on goods carried by road and terminal taxes on passenger and goods carried by Railway, sea or air are instances of unsuitable taxes devolved on local bodies generally such as Municipalities. These taxes hinder the growth of industry and commerce on natural foundations and stultify trade. This is a primitive form of taxation giving plenty of scope for evasion and necessitating a complicated and unremunerative administration. Diminishing Returns set in sooner here than in any other form of taxation. Yet these taxes are still there.

Question 191

Yes. Even though Section 145 (1) of the U. P. Municipalities Act permits revision in the assessment before the lapse of a given period between two assessments, yet the U. P. Government and the Municipal Board's interpretation of the section otherwise to mean the possibility of revision once only in five years does not impart promptness and flexibility to a suitable category of tax. In spite of Section 128 of the U. P. Municipalities Act, the imposition of tax on trades and callings become difficult when resources are most needed by the procedure to be adopted in obtaining sanctions. Instances can be multiplied to show how Commissioners and District Magistrates having not the time or equipment to adjudicate upon such question delay unnecessarily considerations of proposal put before them towards such ends.

Question 192

Yes. See answers to Questions 190 and 191.

Question 193

(a) In Uttar Pradesh while the powers to decide whether or not to levy the tax and to determine the

rate of levy are not devolved upon local bodies excepting in rare circumstances powers to assess and collect tax have been fully devolved on them subject to the limitations imposed by the State Government in the matter of any particular tax and its rate of levy.

(b) Please see answer to Question 185. In the U. K. in the case of local bodies if the actual collection of tax is even 95 per cent. of budgetted revenue under that head enquiries are immediately set afoot to trace the weak spots. In India even 60 per cent. collection in the case of local bodies is endured with complacency. Maintenance of standard of collection has to be more closely looked into.

(c) In the present state of civic sense literacy and the resources for the management of local bodies a correct answer to this question from correct perspective capable of helping in the consideration of the issue does not appear possible.

Question 194

No comments in view of answers already given.

Question 195

(a) There is a considerable lack of co-ordination between the local taxes themselves in respect of Municipalities in the U. P. and this lack of co-ordination is carried further between these taxes and allied States' taxes and Central taxes. A case in point is the levy of Octroi in Allahabad, Banaras and other Municipalities and terminal tax in Kanpur and Lucknow Municipalities, the former on an *ad valorem* basis and the latter on a specific basis dependent upon weights and measures. Commodity taxes at the State level such as salestax where value as represented by sale price is the determinant and central excises on commodities produced in U. P. such as cloth and sugar on the basis of weights and measurement can apparently have no established co-ordination with local taxes specified above. The assessment of when and how diminishing returns start operating in respect of each one of all the above taxes becomes well nigh impossible. That all these taxes affect only trade and commerce and that too adversely cannot be denied. In a totally sellers' market and under conditions of super-imposed State controls perpetuating artificial shortage any illogical combination of these taxes without co-ordination does not show up the evil effects of anyone or all these taxes. But in the circumstances of free competition, private enterprise and buyers' markets their marked evil effects appear in direct proportion to buyers' resistance and the rigidity of cost structure. Much more is lost on swings than is gained on rounds in the matter of commodity taxes local, State and Central. The remedy will be found to lie in the use mostly of direct taxes and service fees inducing surplus revenues from public utilities for financing local bodies rather than indirect taxes affecting commodities.

(b) Most certainly yes. Even a small retail trade has become impossible in the context of all the formalities one has to fulfil in respect of different taxations local, State and Central. There is no end to harassment caused to trade and productive efforts by each tax authority pulling its own way and imposing its own conditions and rules. Administrative and fiscal co-ordination between the State Government and local authorities and the simplification of procedure for assessment and collection of taxes and the use of statutory rules and orders only as a means for tax collection with an eye on equity rather than as an end itself are some of the remedies to undo this evil.

Question 196

No Comments.

Question 197

No Comments.

Question 198

Please see answer to Question 185.

Question 199

If it is necessary at any time to equip local bodies with additional resources beyond their powers of taxation resort must be had only to the assignment of a proportion of salestax and entertainment tax in the case of City Corporations and Municipalities and Land Revenue and Agricultural Incometax in the case of District Boards and Village Panchayats.

Question 200

There is much in the contention that lands under non-agricultural use and buildings are subject to multiple taxation of the same source of income and that, therefore, there is need for correlating the taxes levied by the Union under Section 9 of the Incometax Act, the urban immoveable property tax levied at the States' level and taxes levied by local bodies on property into a rationalised system. There should be a uniform basis of valuation for all the taxes concerned Central,

State and Local and the annual rental value of the property should be the basis of valuation.

Question 201

Please see answer to Question 200. We agree with the recommendations of the local Finance Enquiry Committee in so far as they desire no change from rents as the basis of valuation.

Question 202

Please see answers to Questions 187 to 190. We agree with the views of the Local Finance Enquiry Committee in respect of Government exercising powers of local bodies to collect property tax in the case of the failure of the latter to do so.

Question 203

Exemption need, however, be granted to property the annual rental of which falls below Rs. 120 a year and those owned and exclusively utilised by educational and charitable institutions duly approved by the State Government. Houses built under subsidised Schemes for the purpose of letting out at a specified rent such as Industrial Housing may also be exempted from property tax for the number of years such houses remain bound by indirect mortgage to Government in terms of loans advanced on them by Government. All State and Central Government properties used wholly for the purposes of office accommodation might be exempt from taxation but in no case such properties when they are used for residential or commercial purposes.

Question 204

Property taxes should not be progressive.

Question 205

City Corporations, Municipal Boards, Town Area Committees, Notified Area Committees, Cantonment Boards are the categories of local bodies that should be empowered to levy property tax. The maximum and minimum must be specified by the State Governments in the respective Act concerning those local bodies. Valuation and the determination of annual rental value must be in all cases quinquennial by valuers appointed for that purpose by the State Government in every case. In the case of failure of any local body to account for reasonable collection of tax State Government must have power to impose and collect taxes.

Question 206

Excepting the suggestions that the U. P. Government may set up a panel of qualified valuers to evaluate property subject to tax by local bodies quinquennially and that there is a greater need for vigilance and supervision on the part of State Government over the acts of commission and omission by the local bodies in this respect, the present administrative arrangements as noticeable in U. P. seem to be satisfactory.

Question 207

In respect of what are called 'service taxes' we entirely agree with the majority findings of the local Finance Enquiry Committee. All Central and State Government properties enjoying exemption from property tax should however be subject to 'service tax' determined by the evaluation of such services in such properties.

Question 208

With the knowledge of 'local rate' collections in Uttar Pradesh, we consider that the system of local fund cess both administratively and fiscally is satisfactory in operation. Abolition of Zemindary is not expected to prejudicially affect cesses here in view of the compulsory nature of its imposition and collection and being handled by the Land Revenue collecting machinery.

Question 209

Octroi and terminal taxes have been condemned by Committee after Committee and admitted by financial heads of Government since 1901 all over India as the most primitive form of taxation suitable for application to a water-tight self-sufficient economy of semi-rural type and as inconsistent with the economy as we understand it at present. Yet this taxation could not be scrapped from the Statute Books and Constitution of India by virtue of force of habit and a general disinclination to sacrifice a source of revenue, however imperfect. The introduction of terminal taxes to replace octroi, the former being a modified octroi without refund capable of centralised collection through Railway administrations, necessitated in U. P. the simultaneous initiation of an anomalous tax system known as 'toll at terminal tax rates' which is a contradiction in terms and which in reality is the disappearance of tolls and the re-emergence of octroi functioning side by side with terminal tax. There has been an increasing tendency on the part of Railway Administrations to do away with the responsibility for the collection of terminal taxes at source and accounting for them to the

Municipal Boards concerned even when the Municipal Boards concerned are prepared to part with a greater portion of such collections as charges for the same. The case in point is that of Kanpur, the terminal tax affair of which was taken up in 1951-52 with the Railway Board on behalf of both the business community and the Municipal Board by this Chamber, without the Chamber being able to induce the Railway administrations to involve themselves in the affair. With this feature of centralised collection of terminal tax absent, terminal tax at once becomes octroi with more regressive features attached to it. Under such circumstances, the maintenance of permanent staff with a number of outposts and the provision of skilled staff to interpret rules in this connection along with the machinery for appeals, if any, are bound to cost local bodies such amounts as will ultimately be found inconsistent with the taxes to be gathered. At the same time this tax system has been found exposing the Boards and their office machinery to temptations and the consequently legitimate charges of corruption and nepotism besides allowing great scope for dodgers and evaders to indulge in malpractices in almost an unrestricted manner. Taking this tax in varied forms as a necessary evil without alternatives at the moment when this question was considered, the Taxation Enquiry Committee 1924-25 sought to frame this measure within grave limitations as to rates, refunds, class of goods, character of goods, means of transport employed, exports and imports. State Governments agreeing with these limitations had been having considerable difficulty with the Municipal Boards in keeping them pinned to the principle of the least exploitation of this source of revenue. The policy of least resistance in the matter of Municipal finances and a general disinclination to devote the necessary time, labour and thought to local civic Government problems usually land the Municipal Boards in the consideration of suggestions to modify the terminal tax and toll schedules irrespective of the economic consequences of such moves. In one such attempt by the Kanpur Municipal Board in 1950, the Chamber had occasion to review the position. Excerpts from that review being relevant to the subject under consideration are reproduced here for the understanding of the problem in its corrective perspective. After pointing out that Kanpur's increase in population fourfold within about 10 years necessitated the provision by the Board of better and expanded civic amenities and that that provision would certainly take up the overall expenses of the Board it was shown by examples and worked out figures how it was possible to account for considerable economies in bigger undertakings than in smaller ones and therefore of a decrease in the *per capita* expense of the Board. If dishonesty, in aptitude and lethargy were removed, it was shown that the Kanpur Municipal Board could account for an increase of about 10 lakhs normally in their revenue from all the existing sources without any alteration in the rates of any tax. The review *inter alia* had to say the following in respect of terminal tax schedule that was then sought to be revised.

"If in the above background terminal tax and terminal toll are viewed, it will be seen that the revenue derived from this source which in the year 1946-47 was Rs. 11.28 lakhs and Rs. 2.28 lakhs respectively increased further in the year 1948-49 to Rs. 11.65 lakhs and Rs. 4.29 lakhs respectively lending enormous scope for further rightful exploitation. The collections during the first nine months for 1949-50 from the above sources were shown at Rs. 7.62 lakhs and Rs. 3.67 lakhs respectively. The Council of my Chamber firmly believe that with the present industrial and commercial expansion of Kanpur, the consumption of materials liable to terminal tax has also increased considerably and if the revenue has not registered a corresponding increase, it is due to the operation of various control measures and the frequent imposition of restrictions on the movement of commodities by rail necessitating the employment of motor transport. The staff employed over terminal barriers, under the above circumstances, would be found not to have discharged their duties as they ought to have in order to secure the rightful dues of their employers, i.e., the Municipal Boards. If both the public and private carriers laden with taxable commodities are checked without yielding to temptations or lethargy a great improvement in collection can be made possible. The Board should, therefore, first of all set their house in order rather than thinking in terms of a revised schedule for an enhanced import tax. With the return of normal trading condition and improvement in wagon situation, trading activities of Kanpur will automatically register a greater import and export giving place to a better revenue yield from terminal tax. Under these circumstances, the Council of my Chamber record their emphatic disapproval of the introduction of the cess schedule with the rates of imports tax mentioned therein.

The provision for the collection of the proposed cess departmentally is all the more objectionable because it defeats the very first canon of taxation that the collection of tax should involve least expenditure and should not be cumbersome. Before commenting in detail on the contents of the proposed cess schedule circulated to us with your letter, I may be allowed to draw your attention to the fact that buyers' market has come on its own everywhere and that it is becoming almost impossible to establish and maintain any industry or trade owing to the peculiar and complex depression we are all facing. While prices do not lend themselves to any further fall, costs which are no longer under the control of the entrepreneurs and the management tend to be rigid and looking up. Profits are next to nothing in enterprise and money conditions have become tighter to make money unavailable except under exceptional circumstances. Any tax scheme that might become a success in a sellers' market temporarily is bound to act adversely on trade and industry in normal times drying all other sources of taxation too. The Municipal Board should not forget that Kanpur is in a far greater measure a distributing and producing centre rather than a consuming centre. Its productive and distributional activities are characterised by acute forces of competition in normal times to which we have drifted. It is the traditional skill combined with possibilities for lower costs that has given Kanpur that place in Uttar Pradesh in particular and in Northern India in general. The Municipal Board by foisting a cess schedule for gathering a greater quantum of tax will have subjected almost every article of industrial use and distributional trade to terminal or toll tax and will have thus added to the troubles of costing and price-structure a greater element of rigidity consequently obliterating the industrial and distributional trade of Kanpur. The artificially increased revenue for a year or two will have created many a hole in the fabric of Kanpur, the Municipal Board of which after a couple of years will have been left with all dried up sources of revenue. The Board will, therefore, do well to think of the enormous harm that they will be doing to Kanpur and the insolvency they will be inviting upon themselves by their short-sighted policy of introducing an unworkable import cess schedule. Even a cursory examination of your proposed cess schedule containing different rates of levy on different items of imports into Kanpur classified rate-wise goes to show that the cess schedule in question has certainly not been based on either any statistical information or specific data relating to the possibilities for revenue collection, quantum of revenue as may be needed and can be gathered, economic implication of each item of the schedule and procedural and definable details. The entire scheme betrays a clear lack of realism and serious consideration. Taking item No. 28 in the cess schedule referring to coal, charcoal, coke and patent fuel as a case in point, I wonder if the Municipal Board had ever taken the slightest trouble of ascertaining the total imports of coal in Kanpur, the agencies that import and use them, the purpose of such imports etc. to be able to assess the possibility of revenue from import cess on coal alone and their attendant repercussions, leaving aside other considerations such as the incidence of this levy, its reaction on essential services such as generation of electricity by the public utility service here and of power by certain industrial concerns etc. etc. If the Kanpur Municipal Board is not aware of the fact that these major details must be considered before any such levy can be decided upon, God alone must help the administrative equipment and talents of such a Board. If, on the other hand, the Municipal Board trot out the plea that they have not enough material and skill at their disposal to equip themselves with this background material to enable them to assess each suggestion in their schedule in proper context, my Chamber and like organisations are prepared to nullify that plea by placing their services and resources at the disposal of the Board. Had the Municipal Board been in possession of even certain major details enumerated above and had they gone even superficially into our production trends and factors in industrial economy, they will have found it impossible for them to eschew an item like item No. 28 figuring in the cess schedule. About 25,000 mds. of coal for industrial use alone is imported into Kanpur everyday and a levy of 0.1-0 per md. on this coal alone leaving aside the rubbles coke etc. will yield from the proposed import cess a revenue of about Rs. 1,500 a day. That means that the annual yield only from this item of cess schedule would be to the tune of about Rs. 5,40,000 a year to the Municipal Board. My Chamber fail to comprehend the extent of revenue that the

Municipal Board desire to net in through measures that have the sure prospect of obliterating all forms of industrial and commercial activities from Kanpur altogether. If all items in the proposed cess schedule are taken into consideration individually in the manner detailed above, it will be found that the import cess schedule has been prepared to produce for Kanpur alone a revenue capable of sustaining four such Municipal Boards and administrations. It, therefore, obviously appears that neither much attention nor thought has been paid to the construction of a scientific cess schedule. Local Self Governing institutions such as Municipal Board should not come with such flimsy and half-baked proposals for taxation specially when every one of its measure is likely to affect not only the interests of Kanpur City but also of U. P. State as a whole in the context of Kanpur's importance as a producing and distributing centre."

With the multiplication in the means of transport as well the speed with which they operate, the changing conditions of productive technique and economy, trade has grown not only more technical and varied but has become complex. Terminal tax and octroi or any combination thereof are essentially taxes on trades and not so much taxes on consumption. They have almost become impossible to assess in an equitable and scientific manner in the context of the complexity of modern trade and productive technique. Transit traffic being very much affected by this tax despite provisions for exemption, this tax will appear to interfere unjustly with normal trade and distribution of commodities on a rational basis. There is no other tax that offers scope for fraud, evasion, underassessment, petty harassment, nepotism and extortion as terminal taxes and octroi taxes. It has been found that even with the best of statutory procedure and prescriptions, there are always loopholes left in the system of terminal taxes which is supposed to be an improvement on octroi and which the former seeks to replace. In letter No. R.72-1939/XI-243 dated the July 13th, 1940 addressed to the Commissioners of Divisions in U. P., Secretary to U. P. Government in the Municipal Department says that the cardinal point in the policy of the Government is the gradual extinction of octroi and that public interest and the need for consistency demand the consideration of an alternative method which may meet the end in view (end here is the repair to diversion caused to trade by the discriminatory effect of terminal taxes where they are imposed) without retrogression to octroi. Yet we find that U. P. Government allowing Municipal Boards all these years to levy 'toll at terminal tax rates' thus introducing by backdoor, according to their own admission, octroi without the exemption of even the transit trade. Indirect taxes are mostly unsuitable for local bodies as has been pointed out throughout in these answers in different parts and this particular tax very much so. Either exclusively or in combination, terminal taxes and octroi can be clearly shown as having detrimental effects on production and trade and as sapping other sources of revenue both State and Central. In the light of the above views of the Chamber on octroi and terminal taxes and in the context of the legal opinion obtained by Government of India that a Municipality which is levying a terminal tax can continue to do so at the existing rates even after it has been raised to the status of a Municipal Corporation, we cannot do so better than to agree with the Delhi Municipal Organisation Committee 1947 when they say "Terminal tax should be eliminated altogether from the tax schedule of the Corporation though the immediate objective may be reform rather than abolition. In the imposition of the tax, the Corporation might distinguish between articles of consumption which are imported ready for use and those which are imported as raw materials and in a semi-manufactured condition and are mainly re-exported after manufacture". The important point to remember is that local trade and industry should be encouraged and the tax should be so adjusted that such articles (a) which form the basic raw materials of industry and (b) which are imported with a view to mostly re-export are altogether exempted and that the articles of necessary consumption are governed by lowest rates possible.

Question 210

Yes. Octroi and terminal taxes or any combination by whatever name they may be called should altogether be abolished though this abolition might be gradual and accomplished in the next five years by stages. The most compelling reason for such abolition beyond others already discussed, is the altered condition in the structure of commodity taxation with the introduction of Salestax all over India. The Municipalities must be made to depend more and more on direct taxes within their jurisdiction and non-tax revenues rather than on indirect commodity taxes. Levy of surcharge on salestax on behalf of either all or some Municipal Boards is neither feasible nor desirable because salestax takes

the form of a turnover tax in this country and its implications are statewide rather than localised and the levy of surcharges will at once give place of discrimination. Yet keeping in view the proportion of the contribution to salestax by each Municipality to the total salestax revenue of the State, 25 per cent. of the collection of salestax may be earmarked for distribution to the Municipal Boards for a period of time on condition that such Boards will (a) gradually but within the period marked by the distribution of the proceeds of salestax extinct terminal tax and octroi taxes within their jurisdiction, (b) develop non-tax revenues by that time to the tune of their loss by the extinction of terminal tax or octroi, (c) actively render assistance to the Salestax machinery for better realisations of salestax within their jurisdictions. Legislation on a State basis must be undertaken to secure the ends in view.

Question 211

In view of answers to Questions 209 and 210 no comments are needed.

Question 212

The question itself seems to give the status of customs duties to terminal taxes and octroi when 'bonding' is thought of. As it has already been pointed out in answer to question No. 209, it is impossible to think scientifically of this tax and to correlate the same with other commodity tax measures. Hence it is futile to think of developing ideas on exemptions, procedures for collection, rates of levy etc., etc.

Question 213

As long as octroi and its variation terminal tax continues the basis of assessment should certainly be by weight, measurement or numbers and not *ad valorem*. Procedural delays and difficulties will be at their minimum in the basis of assessment recommended. Complete elimination of procedural delays and difficulties being impossible in the administration of this tax howsoever efficiently it is handled, it is better to tone up the moral fervour and sense of responsibility of the machinery entrusted with the administration of this tax and make the best of a bad bargain until it lasts.

Question 214

No. The loopholes and weaknesses inherent in the system of terminal taxes itself are such that they are capable of causing the very same difficulties and posing the very same problems even under conditions of nationalised road transport as they cause and pose today. Just as Railway administrations are reluctant to undertake this work for Municipalities in respect of terminal tax on goods carried by them, just as postal authorities have said that they cannot go any further beyond providing the list of postparcels received and that too on payment by the Municipal Boards adequate enough to do the job and that they cannot undertake to even to verify the contents of the parcel for assessment purposes, the Nationalised road transport agencies will not find it possible for them to undertake this work of goods terminal tax collections on behalf of the Municipal Boards.

Question 215

Octroi or terminal taxes cannot obviously be uniform for all Municipalities in all States and even in any particular State because of the varying conditions of consumption, population, area, needs, expenditure and the sources of revenue of the Municipal Boards in any State. Allied forms of taxes, Central and State, such as Excise, Customs, Salestax etc., both in respect of rates as well as the procedure of levy will be found uniform all over India in respect of central levies and throughout the State in respect of State levies. Correlation in these circumstances does not appear possible.

Question 216

Please see answers to Questions Nos. 168 and 169 in Part V, under motor Vehicles Taxation. There should be no tax on any goods carried by roads. The Chamber recommends its deletion altogether from the State List in the Seventh Schedule of the Constitution.

Question 217

While the power to sanction the levy and to fix the rate of levy must be retained by the Centre as at present under item 89 of the Union List in the Seventh Schedule of the Constitution, all pilgrimage Centres and big cities capable of accounting for a floating population at least equivalent to 5 per cent. of its total population should be permitted to levy a terminal tax on passengers carried by railway, sea or air, if application is made on this behalf by the City Board concerned by virtue of the resolution of that body through the State Government concerned. The rates should not be below 0-0-6 and above 0-1-6 per such passenger, powers to determine the exact rate within these limits being left by the Centre to the State Government concerned. These rates must form a part of all air, railway and sea passengers tickets costing 0-0-0 and over. Wherever tolls are allow-

ed to be levied such as hill stations etc. this tax should not be allowed to be levied. This tax will not be discriminatory in that the element of tax paid by a traveller by road through motor vehicles and bullock carts in the context of recommendations made will still be greater than this contribution by any passenger by railway, air or sea.

Question 218

With the development of new ideas on taxes on property and cesses on land revenue and increasing reliance being placed on non-tax revenues, 'poll tax', which is an ancient conception of the contribution of an able-bodied man to the communal welfare of the society he lives in has no place in the scientific taxation system anywhere in the world though in theory, it is still upheld in even advanced western countries. The elaborate system of exemption it calls for and the unequal incidence that will fall on the payers thereof makes it impossible to give it a place in the tax system.

Question 219

Taxes on vehicles (other than mechanically propelled), animals and boats are purely local taxes and State Government should have nothing to do with them beyond the sanctioning of the levy of such taxes. Tolls are suitable forms of taxation for small Municipalities and Town Area Committees under exceptional circumstances just like hill stations and health resorts.

Question 220

Taking into consideration the fact that the profession tax is a direct tax and the payees thereof for the most part will be those that pay taxes on income including agricultural income and the burden on them is tolerably heavy with a high incidence, the limit on this taxation placed by the Constitution at Rs. 250 per year should under no circumstance be raised. Profession tax must be confined only to local bodies. Municipal Boards may be allowed to raise taxes on trades and callings and the District Boards on circumstances and property as in U. P.

Question 221

Municipal Boards may be allowed to levy a 'theatre tax' on each performance such as each show of cinema, circus, drama and sports and wrestling bouts etc. etc. arranged on a commercial scale in addition to the State Entertainment Tax.

Question 222

Substantial portion of the gains of private individuals consequent upon the development of land and the provision of civic amenities should be canalised to defray the cost of improvements on hand so as to further add to the value of those very properties. Unearned increments of value and wealth as represented by land and immovable property holdings in any urban area in private hands must be treated as having at least partially come out of the expenditure of public funds in those areas. The entire matter being a continuous process and the development of cities can be extended to indefinite lengths, the local bodies concerned should have powers to impose (a) a special betterment tax with reference to property which stands to benefit from a specific piece of improvement and (b) a general betterment tax. This tax must be collected along with the

general house property tax. The assessment of betterment value must rest with a Board of Valuers constituted by the State Government, who shall also have powers to limit the rate of tax.

Question 223

No comments.

Questions 224 & 225

Please see answers to Questions 185 and 186. Just as most of our tax systems has developed in a haphazard manner so also the utilisation of almost every tax resource has been more or less fortuitous. Once a particular tax system has come into vogue however temporarily and specifically that particular system continues to operate even after the lapse of that specific circumstance. No State or local body appears to have any dependable statistical data in respect of persons and commodities, trades and callings, residence and migration etc. etc. so as to enable the assessment of scope for any measure of taxation. How can tax resources be explored and utilised in the absence of preliminary data? Fuller utilisation of tax resources in the case of local bodies will be possible again by arousing civic consciousness and honesty in the tax collector. These two elements are again conspicuous by their absence. Political demagogues who are able to sway the masses for party ends also appear to be impervious to the needs of the situation here. As long as a partymen's Counsels will be preferred to the results of the patient study of an economist in these matters much improvement in the situation cannot be brought about. The Administrator, specially the tax administrator must be selected for his detached outlook, judicial frame of mind, human understanding and patience.

Questions 226 & 227

No comments.

Question 228

The contribution of manual labour either as an additional tax or in payment or part payment of an existing tax will be found governed somewhat by the same principle out of which the ancient poll tax had developed and can never smoothly work. With huge unemployment and under-employment in the country and any tax system being dependant upon the ability of those that are called to bear the burden of the same to pay, the difficulties by way of comparative costs, assessment of contribution, the manner of availing manual labour and the evaluation thereof will arise and cloud the entire proposition beyond its recognition. This apart the numerous exemptions that will have to be made in subjecting the assess to pay tax in this manner and the difficulties in accounting for the realisation of any tax in this manner will make the realisation of this tax almost impossible. If taxes cannot be assessed and collected in kind even in cases of emergency, how can taxes be assessed and collected in terms of manual labour? 'Shram Dan' aroused by religious fervour or sentimental considerations such as helping public charity and public welfare has the character of volition of the person concerned. Tax is a compulsory contribution and there is nothing voluntary about it. It is, therefore, impossible to give manual labour the place of money or medium of exchange and tax realisations cannot be based on manual labour.

SUPPLEMENTARY MEMORANDUM SUBMITTED TO THE TAXATION ENQUIRY COMMISSION BY THE U. P. *Ad Hoc* COMMITTEE ON TAXATION THROUGH THE MERCHANTS' CHAMBERS OF U. P.

Taxation Enquiry and issues arising out of Government expenditure.

The taxation policy and structure, among other things, should have for their objective a progressive betterment of the standard of living of the people of the country as a whole. In view of the facts that Government expenditure is the apex of taxation policy and structure and that Government expenditure has considerable bearing on the exploitation of economic potentials in the country, an enquiry into the policy and structure of taxation can be effective and fruitful only when the various issues involved in Government expenditure is also fully examined from the utilitarian standpoint and the results of such examination are coordinated with the enquiry into the policy and structure of taxation. Such an elaborate enquiry and examination naturally involves the consideration also of Government's indebtedness and causes and effects of the provision for Debt Services by way of interest charges and other appropriations in the different Budgets of the Central and State Governments. In respect of India, which is an under-developed country and which is on the threshold of planned economic development, the need for such a comprehensive enquiry cannot be overemphasised.

Mere National Income cannot be any criteria for taxation

2. In our anxiety to secure a larger proportion of the National Income for public expenditure, development or otherwise, the impression is sought to be given that only

a very small share of the national income is collected towards taxes and that, therefore, the tax burden is not so heavy as it may be pointed out to be. It is forgotten that the economy of India has not yet fully developed and the *per capita* income in India is considerably lower than the same in other countries of the world. We think that different conclusions will emerge if available resources are evaluated in terms of their capacity for exploitation and yield they are likely to give and the focal point is maintained on the full exploitation of available resources and the betterment of the general standard of living.

3. The prime consideration at the present moment ought to be the creation of more income and wealth and all our efforts should be directed in bringing about a significant increase in the gross national product in order that a distinct improvement in the general standard of living can be achieved. It is only when constructive forces are allowed free play and the greatest emphasis is laid on utilising effectively and efficiently all the available resources, that the objectives of economic development can be realised. There can be no room for difference in approach between the taxing authority and the tax paying public, if adequate consideration is paid to activities that increases gross national output.

Management of our economic affairs in the Public Sector

4. If the management of our economic affairs at the Government level is considered in the light of figures

given hereunder the following broad conclusions will emerge :

(i) Non-tax revenues, which have a great scope for expansion, are relatively in the oblivion at the moment because of our complacent attitude to inefficiency and unsound management in the public sector.

(ii) We have been incurring public debts and sinking our resources so gathered in non-productive efforts also when we can ill afford to act that way at the moment.

(iii) All investments made from out of public debts in India in whatever level, central, state or local, should be made to yield returns, much more than to cover interest charges thereon under the heading 'Debt Services' and this does not appear to be apparently the case.

(a) Total tax revenue in India from all sources to Central, States and local in 1953-54 was to the tune of Rs. 780 crores composed of contributions in taxes to exchequers :

Central	Rs. 425.34 crores
Part 'A' States	Rs. 244.37 crores
Part 'B' States	Rs. 68.43 crores
Part 'C' States	Rs. 6.05 crores
Others	Rs. 36.00 crores

(b) Interest bearing obligations of Governments in India at the Centre and States :

Rs. 4,276 crores composed of :

Central	Rs. 3,876 crores
States	Rs. 400 crores

The obligations arising out of currency in circulation at about Rs. 1,100 crores has been added to the above figures.

(c) As against interest bearing obligations, i.e., debts of the Government of India at Rs. 3,876 crores interest yielding assets are only Rs. 1,979 crores including capital investment on railways.

(d) Our expenditure on Debt Services (Interest & avoidance of debts) in 1953-54 was Rs. 54 crores composed of :

Central	Rs. 37 crores
States	Rs. 16 crores
Others	Rs. 1 crore

5. In so far as we accept the system of mixed economy, Governments cannot be denied the right to own and operate public utilities in public interest. But the operation of all utilities should be on strictly business lines with the same obligations imposed upon the units in private sector as on units in the public sector in respect of accounts, taxpayments, commercial audit, fair returns etc. All forms of waste must stand avoided. Social services as might form the normal part of Government's activities must be only within the tax revenue means of Governments and capital obligations should not be incurred thereon for the present. If expenditure on ventures produce results counter to the overall productivity either in agriculture or in industries on a long range basis, such expenditure should be considered waste. Example of Sindri Fertilisers and the inability of soil to take in the products coming out of the Sindri Factory due to water scarcity or other causes can be cited as a case in point. It has been pointed out that when soil surveys are not yet complete, the use of chemical fertilisers cannot be planned. Another example is provided by the Nationalisation of Road Transport which occasions huge drain of public funds simultaneously with the growth of unemployment. All non-productive efforts, it may be pointed out, should be stopped either on the capital or on the revenue forum of Governments for sometime to come.

Main budgetary trends in India and the changing phase of the structure of tax revenue

6. A close study of the Budgetted, revised and actual estimates in the public sector since 1948-49 to this day reveals that there is ample justification for the feeling that Government have been, almost as a matter of routine, underestimating revenue and overestimating expenditure, thus resorting to the 'uneconomic level of taxation' of almost the same infinitesimal section of the population. There has been clearly an appreciable raid on the capital structure of private sector through the adoption of *ad hoc* and faulty measures of taxation with the sole aim of financing the public sector to the maximum extent possible through a policy of least resistance.

Industries in private sector and their expansion to account for satisfactory revenues

7. It will be clear that the Indian tax system to benefit and stabilise must have at its background industry and commerce of the country, especially if excises have to

be depended upon more and more in future and turnover tax has to play its legitimate part. Everyone of the forty-two industries covered by the 1951-56 programme of industrial development as per chapter XXIX of the Report of the Planning Commission, according to the admission of the Commission themselves, is beset with one problem or the other or a combination of problems. All these problems will be found related to the availability of necessary capital, the structure of costing and the competitive capacity of the industry concerned. The paucity of capital resources and the unsatisfactory flow of capital, even to cover the rehabilitation of existing industries, affect almost all sectors of industrial activity and set a basic problem. The success of loan issues on the part of Government last year to the tune of about Rs. 109 crores in the context of the failure on the part of private enterprise to raise even ordinary working capital shows that unless that class of investors, which is mostly from the lower and middle classes and which, in the hope of receiving on stocks a rate of dividend appreciably higher than on Government loans, is prepared to participate in risk capital, is encouraged, there can be little room for optimism. This encouragement, in its turn will be found to require that such enterprises are allowed not only to earn rewards for the risks they run and that taxation in as far as they are concerned is such that the enterprises they own are also given adequate opportunities to build for themselves adequate funds and reserves to be able to wither any storm and to face any emergency. It is clear that the taxation policy at present pursued, specially in so far as it concerns direct taxation, such as taxation on income, is the antithesis of what is needed at the moment.

Influence of Government expenditure on industry and commerce and the revenue yielding capacity of the latter

8. If we accept that the solution of the troubles that arise in the course of the execution of development plans, particularly in industrial and commercial sectors, is the joint and several responsibility of Government, business and labour then it is a little hard to look to business alone to account for cuts in production costs in the face of what appears to be the extension of priorities to the allocation of capital expenditure in the public sector, secured principally, by measures of taxation and in certain circumstances, by other means such as non-tax revenues, fees, loans, deficit financing, etc. It must be remarked that these sources have their due influence on business, those engaged therein accounting for almost the entire resource of Government in this country at the moment. Cost of production in industry can conclusively be shown to depend appreciably upon Government expenditure. When therefore the business and industry is faced with financial difficulties and costing problems, no Government expenditure should be considered sacrosanct save that required by self-preservation from hostile attack and the maintenance of law and order within the country. It should be realised that if money or credit was not there, expenditure would stop automatically. Government expenditure and consequent sources of revenue specially revenue from taxation, which has arisen by almost five times the pre-war standard with the sources of taxation-revenue including the classes of people affected by taxation remaining almost unchanged, therefore, merit consideration in the above context. The application of the brake to the fast moving Government expenditure and the consequent tax reliefs will help reduce the existing high costs, stimulate productive activity, and check the growth of unemployment. In the long run the expansion of economic activity that will follow will raise the Government's tax revenue besides creating greater and varied potentials for revenue thereby more than making good the initial sacrifice on the part of Government. For a country as large as India with a population that it holds, the present revenue budget of the Central Government at about Rs. 400 crores should be considered very insignificant. This needs to be increased many times over. Such a development can be possible only when the real wealth of the country is increased and more and more of purchasing power is placed in the hands of the country's population in terms of the progressive increase in real wealth. Creation of circumstances leading to all these events will appear to depend upon industrialisation, resetting agriculture and agrarian economy and the provision of incentives to people to work hard to save and to invest.

Emphasis on efficiency and economy in State undertakings

9. Some of the schemes of development that have been executed under the Five Year Plan and others outside the Plan executed by some States do not appear to give productivity and efficiency the place they deserve on the purely utilitarian scale. Even the blue-prints of these schemes are reported to be fortuitous and un-

planned. It is said that with a lesser number of gates, we could have accounted for the same performance and the whole thing could have served the purpose equally well in the Durgapur Project. That would have meant a saving of about 50 per cent. on the outlay accounted for heretofore in that project. The case of Chittaranjan was explained in the course of oral evidence by Sir Padampat Singhania. The number of such cases can be multiplied and stressed as taking place under our eyes despite public criticisms thereof all over India. It is here that a considerable lot of economy could be achieved. If monies were spent on these projects carefully and with an eye on the aspect of returns that every pie has to account for, there would always be justification to go to the public for support. There is another aspect of the matter which has to be borne in mind. It has been observed that once efficiency in the construction and conduct of undertakings is allowed to fall, it takes superhuman efforts to bring up efficiency and instil optimum economy in the working of these undertakings and the time taken in that process, at times, outstrips even the utility of the undertaking concerned. If the working of railways in India is viewed in this perspective in the last fifteen years, the truth of this Statement will stand out prominently. It is therefore recommended that all State undertakings barring a very few exceptions, must be run on the basis of private business undertakings with the freedom of action to the boards of these concerns and the charge to such boards to account for fair returns consistent with the possibility for these concerns to face buyers' markets, changes in demand schedules and the needs of the masses at large.

Compartmentalisation of the use of revenue

10. Subject to the foregoing conditions with regard to the construction and conduct of development schemes in the public sector, emphasis is also laid on the fact that development schemes must be, as far as possible, compartmentalised and revenue derived from relative compartments in the form of both taxes and non-tax revenues or earnings and fees must be applied to the schemes of development within these compartments. If this is done, it is believed that tax burdens would be more equitable and development benefits shared by all those that have paid for them.

New sources of taxation and revenue

11. In the course of oral evidence before the Commission, it was revealed that the Governments—Central and Local—would lose something like Rs. 80 crores in tax revenues, if the recommendations of the U. P. *Ad Hoc* Committee on Taxation and the important Chambers of Commerce in the matter of reliefs in taxation and the reform of the taxation structure were accepted. On a careful consideration of the entire matter, tentative calculations reveal that if the structure of taxation is straightened and the suggested reforms are accepted, the shortfall in taxation revenue from the present level may not exceed Rs. 40 crores under any circumstance. In the light of the Commission's direct query to the U. P. *Ad Hoc* Committee on Taxation as to what concrete proposals for tax revenue could the Committee suggest to make good any such shortfall, the entire matter was gone into carefully in the context of present economy, the difference heads and the tempo of expenditure, competitive claims of development programme and the limitations to which we are subject. It has been found possible to suggest certain tentative items of tax revenue as a result of such a consideration. When suggesting these items, the readiness on the part of the Commission to suggest, if necessary, suitable amendments to the Constitution of India has also been kept in view. The suggestions made herein should be taken only as a possible line of approach, the details pertaining thereto being left to be worked out.

(i) Excise duty on cement could be as high as Rs. 22 per ton and that on steel of all kinds Rs. 20 per ton. Based on present production figures, these two excises should be capable of accounting for about Rs. 6 crores in addition to what they are stipulated to produce at the moment. There has been considerable advance in building industry and in the tempo of new constructions all over. The imposition of this duty will lead to considerable improvements in architectural and constructional standards with an eye on utility combined with economy. It cannot be denied that this will be a welcome achievement. This duty, high though it may seem, will not cast undue burden on anybody on the other hand improved efficiency and economy in use of materials will reduce the overall costs of construction to an extent that, even after bearing in full the incidence of these duties, the beneficiaries and the users of such buildings and constructions will be found to be more advantageously placed than at present.

(ii) The tempo of building activities and the advance made in and the scope for building industry suggest openings for other constructional activities such as roads, public constructions etc. which should also consume these two essential materials of construction with

an eye on economy with utility. In addition to these constructions contributing in their own way to the excises stipulated above, their advances suggest new possibilities also. One such possibility is a levy on bullock carts as a central intake. The Motor Vehicles Taxation Enquiry Committee place the bullock carts using roads in India at about 60 lakhs. The Indian Road Transport Development Association figures this out as near about a crore. Even assuming the figure of 60 lakhs as the correct conservative estimate, a tax for road development, at Rs. 5 per bullock cart, a central levy, if necessary, after a slight change in the Constitution of India, can be thought of with the stipulation that this levy shall not interfere with land revenue adjustments for existing collections on behalf of local bodies. Petrol and Motor spirit can be made to bear still heavier burdens in the context of these developments in addition to this levy on bullock carts. Revenue from taxation in these levies may yield Rs. 6.5 crores to Rs. 7 crores in addition to revenues now derived.

(iii) The biggest State industry is railways. By more efficiently operating it and by securing maximum economy possible in all directions this state industry can be made to yield better results. Since the present levels of Railway fares and freights are more or less commercial optimums increase in fares and freights as such cannot be recommended in a serious vein. Nevertheless a levy of development charges in the nature of excise or surcharge on *ad valorem* basis on tickets and railway receipts may be collected and such collections to the last pie be canalised into railway development schemes without treating them as railway revenue in the course of business and operation of railways. This could be as much as 7 per cent. to 10 per cent. of the freights or fares paid or to be paid. Revenue from this source should account for about Rs. 35 crores a year.

(iv) There are about 7.5 crores to 8 crores houses in India at the moment. New housing schemes are well under way. While urban areas may account for a crore to 1.5 crore houses, rural areas may account for the rest. With a light modification in the Constitution, a central capital levy at a flat rate on each tenement can be levied purely for development purposes. A levy of Rs. 5 per year per tenement excluding hamlets in rural areas may be considered as a feasible proposition.

(v) A tax ranging from Rs. 5 to Rs. 8 per employed person deducted and collected at source once a year as a central levy may be considered. All revenues derived from this source must be applied to alleviate unemployment.

(vi) To the extent recommendations under (ii), (iii), (iv) & (v) lighten Centre's commitments on planning for development on the lines indicated, the pressure on Central and State finance will be lighter. This apart the taxation structure will have so evolved as may offer resilience in exploitation as development progresses, industries expand and more wealth is created.

Modifications recommended in the Indian tax system

12. Having regard to the above views, the Indian tax system would seem to require modification somewhat on the following lines:

A. The tax system should be broadbased on different indirect taxes so that tax yields therefrom could be enlarged according to needs from time to time and without impeding the progress of economic development in relation to available resources.

B. The reliance that has, heretofore, been placed on direct taxes such as taxes on income as the principal source of Government revenue must be given up and useless spending and consumption including those on luxury and prestige levels must be discouraged by preventive taxation, direct and indirect.

C. In order that the evil effects of direct taxation at a high level may be kept under control and check the following measures may be adopted.

(i) Rates structure of taxation on income should be so adjusted and progressive as may be capable of encouraging personal initiative and acting as incentive for the expansion of productive activities.

(ii) The system of taxation on income and the mechanism administering the system should be so modelled as may leave appreciable residue of income to be available for disposal and with the proviso that if that residue is canalised into savings and investments the same might enjoy adequate tax reliefs and concessions and if the same is canalised into personal spending and prestige building activities, that residue or the part thereof so spent might be subjected to taxation on almost penal levels for sometime to come.

(iii) Corporate profits should be encouraged specially when such profits are not distributed by special reduction in the tax on Corporate incomes so retained and used for further productive ends.

SECTION 2

REPLIES OF ORGANISATIONS OTHER THAN CHAMBERS OF COMMERCE

NOTE.—The full list of organisations which sent replies to the Questionnaire of the Taxation Enquiry Commission is given in Appendix B of Part I of this volume.



ANDHRA

BHARAT KISAN SAMMELAN, NIDUPROLU (CAMP)

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

General

1. We agree with (a) and (b) as being the best objectives of a sound tax policy (that is reduction in inequalities of income and wealth, encouragement of incentives to work to save to invest).

2. The most important criterion is whether the burden of tax system as a whole, as levied by all public authorities Panchayats, Municipal Councils State and Union Governments, bears equally on different sections and classes of our people. At present, the agricultural masses, especially the small-holders are made to bear disproportionately higher tax-burdens.

3. On the whole, it is true to say that our present tax system does not conform to the principle of ability to pay. The burden of land revenue is based upon the right of the state to appropriate 50 per cent. of the net income irrespective of the income of our agriculturists while the income-tax burden does not reach that limit until very high income-levels are reached. The tax-burden's borne by our landholding peasants are highly regressive.

4. So far, the upper middle classes and richer people have had to pay much less than what they can be expected to bear and certainly less than their proportionate share, when the marginal utility of incomes is kept in mind.

5. The answer to this is dependent so largely upon the manner in which the present disequilibrium in tax-burdens on different classes is sought to be eliminated.

6. At present, there is a strong case for reducing the burden of indirect taxes; especially of those taxes like Sales taxes, profession taxes which fall on the lower income groups. This is a matter which deserves careful and scientific study and which so largely depends upon the financial exigencies and political possibilities.

7. It is possible that the State may undertake both directly and indirectly a number of industrial and commercial, even agricultural enterprises and the income therefrom may go on swelling. Yet, it is equally possible that for the first ten years, these enterprises may not be able to yield net profits. It is also probable that political considerations may prevent the emergence of any profits and the state products may come to be sold on a no-profit and no-loss basis.

8 and 9. We do not agree with the view that the proceeds of special or particular taxes should not be earmarked. On the other hand we feel strongly that the present land revenue and other taxes that are imposed on our agriculturists should be progressively replaced by cesses imposed to finance specific public activities specially intended to benefit our agriculturists or certain sections of them. We have in mind the cotton cess, oil-seeds and oils cess.

10 and 11. This depends so largely on the political decisions of Governments, generally speaking it would be best that Government enterprises are so managed as to yield good enough profits, to be utilised for general revenues or even for specific developmental purposes. Therefore the price-fixation policy must be such as to yield good enough profits, consistently with the ability of the consumer to pay.

12. The answer to this question depends upon the social policy of the Governments; that is, whether it is intended to induce educated people to go to villages or to towns, to force rural people to migrate to towns, etc. Ordinarily urban people are able to earn more, that too comparatively easily and under easier conditions of life and better conditions of work and so, they ought to be made to pay more, but actually it is the rural people who are made to pay more. Income must be treated as the best criterion for differentiation, instead occupation like agriculture is wrongly taken up by Governments as the criterion. For the mere sin of owning some land as a means of employment, cultivating land as a source of income, a peasant is made to pay, as a kind of tax on employment itself.

13. We have already said that our agriculturists are being discriminated against and even among them, the small holders owning 10 acres of wet land or 20 acres of dry land who form 90 per cent. of our land holders are made to bear too heavy a burden.

14. Contrary to the wrong assumptions made by so many economists and political leaders, the economic weakness of the small holders and middling peasants has only been reduced slightly but their comparative economic

position *vis-a-vis* the urban classes has not improved since 1939. On the other hand, the richer peasants, the urban upper middle classes and richer classes have certainly benefited by war-time boom. On the whole the agricultural classes are not better off, comparatively.

15. It is true that the additional book-keeping and other office-equipment necessitated by the sales-tax added to the financial and psychological burdens.

16. The urban classes receive the major portion of the benefits of public expenditure; yet, they pay less in taxes. Yet it is so difficult to make people pay higher taxes on account of public services, except by way of special cesses.

17. We are unable to provide statistical or otherwise detailed evidence but we do feel that agriculture, as an industry, is weighed down specially heavily by the present system of taxation. We urge a scientific and non-political enquiry into this question.

18. We are not so certain that adequate funds can be raised through taxation for any large-scale economic developmental programmes. Yet, much can be done by the utilisation often through voluntary means or some times through compulsion of much of the unused or under-employed or unemployed labour, during convenient seasons, for achieving many of our developmental programmes (especially of small-scale) and also for the benefit of rural areas.

19. The order of precedence suggested in the question will be alright upto the (a) and (b) and (c). But (d) i.e., fresh taxes should be placed next to (e) development of non-tax revenues; such as the utilisation of waste lands, Fisheries, Forest produce.

20. So long as we have to depend upon private sector also in industries for our national development, our taxation policy should be so moulded as to promote the incentives to invest, and plough savings in further development and to work, especially in the managerial sectors.

21. Any concessions given in tax-levies to capital ploughed back into industry, as distinguished from tax levies on capital or profits earned but spent on current expenditure; similarly concessions on expenditure on capital-goods will go a long way to help towards capital and industrial development.

22, 23 and 24. Special and scientific studies must be made to examine these points.

25. It is easy to say 'yes' to this question. But our experience of the working of the controls over imports, exports and internal distribution cautions us against regulating consumption of too many goods or at too many points of social life. Our long-time experience of taxes on tobacco, drink has shown that though tax might bring in increasing revenues, they could not effectively check consumption.

26. It is hazardous to think that tax policy is capable of promoting in a measured manner the efficiency of the productive system. The import and export policies and Revenue Duties do render some effective help but it is not easy to measure such help or its distribution between the various sectors of the same industry. This is why economists favour direct subsidies and controlled assistance to produce more or less ascertainable development in desired directions. Anyhow these policies are generally determined by Legislatures, not so much on the advice of experts as because of political exigencies.

27. Tax system cannot be the principal engine to secure any order of priorities in development. The activities of the Industry and Commerce Ministries especially in the spheres of Import and Export policies supplies of raw materials, capital and transport facilities and price policies can be of much greater importance.

28 and 29. It is not easy to offer any comments on these points; though they sound so familiar. These are also some of the many dark corners in the realm of our knowledge regarding the effects of taxation; and they all deserve pilot studies before any views can be ventured even by economists.

30. No. On the other hand, the present tax policy worsens the existing inequalities of incomes and wealth.

31. Lowering of tax-burdens (direct and indirect) on our agricultural classes, is one of the modifications needed.

32. Public Expenditure for the benefit of rural mass poorer classes can minimise inequalities of incomes more.

effectively and directly than the manipulation of the tax-system; other than the Land Revenue. But the lowering of the burden of land revenue or its complete abolition can help our farmers most directly and thus help towards the minimising of the present inequalities between agricultural and non-agricultural classes.

33. Our constitution does not permit any discrimination against Foreign Capital. And it is not good policy also to moot such a proposition.

34. The various tax-possibilities indicated in Article 269 of the constitution have to be explored, not all together, but only in answer to the growing needs of the States and in relation to the rising capacity of the people to pay them. For instance, (c) and (d) if taxes on railway fares and freights are to be levied, and also on goods and passengers carried by railway, sea or air, the proceeds must be ear-marked for the development of railway and co-ordinated road communications.

35. We are definitely and generally opposed to the reimposition of sales tax, surcharges on land revenue, betterment levies, agricultural income-tax.

At the same time, non-agriculturists seem to be considering the details of any proposals intended to levy a surcharge on the land revenue to be paid by bigger land holders having more than 50 acres of wet land or 100 acres of dry land, provided others owing less are to be definitely exempted and there is an assurance that Income-Tax on agricultural incomes will not be levied, in addition to such a surcharge.

Betterment levies on holdings above a prescribed minimum area to cover only a portion, not exceeding 50 per cent. of the cost of any project in the developed areas and 25 per cent. in the hitherto undeveloped areas and to be recovered in ten or twenty small, equal, annual instalments to be collected only after the first five years subsequent to the inauguration of any irrigation or drainage scheme are also being considered by economists, planners and urban intellectuals.

But great caution must be bestowed by political leaders and economists and consideration shown to the actual needs and ability of the local peasants before any serious and detailed consideration is given to these proposals, i.e., surcharge on land revenue and betterment levies.

Our agriculturists have suffered so much and for so long by the State's neglect of their most essential need for irrigation and Flood control facilities, while so much of public revenues were being spent for the development of urban areas, their industries, trades, educational and other cultural equipments that it does not at all seem to be just to them that they must now be made to pay either in full or in part, so directly for the development of irrigation and Flood Control Projects and facilities and no wonder, they have put up such a stiff opposition to the Madras Government Proposals in this direction.

Moreover the present system of land revenue is so regressively heavy and presses so hard on the very source of employment and living of our peasants that they cannot think of permitting a surcharge to be levied there upon. For too long a time, agricultural income-tax has been proposed by most economists and legislators also. But there were then the big Talukdari landlords. With the abolition of the Zamindari system and the growing distribution of land among millions of peasants in all the areas where formerly there were the big Zamindars and Talukdars, the proposal to impose agricultural income-tax is not likely to appear so progressive or attractive.

If the present land revenue system (not excluding the rate) is to be replaced completely by agricultural income-tax, leaving atleast as big an exemption limit as under the usual income-tax system, there may be much to be said for it, although, it is bound to create more trouble to the farmers and Government in its administration. If it is to be levied on top of or in addition to the present land revenue duties, there is absolutely no justification for it and our farmers are sure to resist it with all their might.

Moreover the experience of both Bihar and other State Governments which have imposed it, when there were the Zamindars was not so encouraging, even from the standpoint of collections.

36. Provided there is no proposal to levy any betterment tax, the desirability of levying a tax on unearned increments in value of land and other property as a result of public projects of development may be considered. That too, subject to the condition that the sales of lands of small-holders having less than 10 acres of wet land or 20 acres of dry land are exempted, since such small holders are often obliged to sell a portion of their lands in order to liquidate their debts or to improve the rest of their holdings. It is also necessary to consider the advisability of not levying such a tax on such unearned values during the first five years of the special development.

37. To increase revenues from existing taxes two means may be adopted either separately or simul-

taneously to make the taxes less onerous and conditions of assessment, etc., less complicated and exempting those from taxes who are more numerous but who contribute comparatively very small portion of the tax-revenues or to increase the efficiency and honesty of the collection-staff and minimise their powers, capacity and practice of harassing tax-payers. This is a matter for experts in tax-collection and the Finance Ministry.

38, 39. For the time being it is best not to frighten people with proposal for new ways of taxing our masses or classes, either through the State Governments or the Union Government.

Export Duties.

113 and 114. It is only in the case of such of our exports for which we have a practically unchallengeable monopoly, can there be a clear case for export duties. Jute is one such thing. Even in that case, we have to be extremely careful, as the substitutes are growing in their importance. On the whole it is best not to resort to this means. In fact we lost heavily by imposing export duties on groundnut, linseed, etc.

115. Yes. We must utilise the proceeds of our export duties entirely for the benefit and protection of the producers and merchants interested in the products paying export duties.

116. Indeed, State trading in our exports will be preferable to export duties, because, the prices of our exports will be capable of quicker readier adjustment in accord with conditions of competition in foreign markets than export duties. It is for experts to formulate detail proposals for the constitution, management of the State Trading Corporation with or without the partnership of private enterprise either as a monopoly concern or as a dominant cartel in the export trade.

Central Excises.

117. Betelnuts, unmanufactured tobacco, especially tobacco stems and rubbish ought not to have been included in our excisable commodities.

118. The differential rates of duty are better. But those varieties of unmanufactured tobacco which are used mostly by the poorest ought to be exempted from the excise duty. The present rates on lower qualities of tobacco are too high; especially on Beedi tobacco.

120. Cottage match industry is certainly benefited by lower excise duty.

121. There is great need for simplification in the present procedure and standing orders regarding licensing, warehousing, transport of our excisable commodities. Many a farmer has come to grief and ruin because of the complicated rules, unsympathetic enforcement of rules and corruption in the administration. Advisory Councils of the producers, warehouse-owners and administration at District and Zonal levels are necessary to iron out difficulties and help the producers, traders, etc., to represent their genuine grievances with a greater chance of sympathetic hearing.

122. Indeed, a good portion of the proceeds of the Excise duties, not less than 6½ per cent. ranging up to 25 per cent. should be set apart for the benefit of the concerned State Governments and the producers and others of the concerned industry or product and that ear-marked sum should be shared equally between the state and the industry. The colossal losses sustained in recent years by the producers of tobacco, jute, oil-seeds lend strength to this demand.

139. We are not at all in favour of the imposition of agricultural income-tax, on top of the present land revenue. If and when it is to be imposed, in place of land revenue, the exemption limit must be at least as high as what obtains in the case of income-tax.

141. The items mentioned in this question have to be taken into full consideration in estimating agricultural incomes. Additional items like (iii) (e) the periodical improvements needed to repair the ravages of erosion, salinity or loss of fertility (ii) (a) the effects of fall in prices of different agricultural products, any adverse turn in terms of trade against farmers, have to be given full consideration.

(b) This idea of averaging the income over a number of years cannot be helpful to agriculturists. It is necessary to be taking into full account the alterations that take place in the prices of agricultural to make peasants suffer from any bad calculations made either by officers or by themselves.

142. It is impossible to venture any suggestions regarding the rates of this tax before we are certain under what circumstances these tax is to be imposed. There cannot be any uniformity as between different states; especially in regard to this tax is Rs. 6,000. The same must be allowed to this tax too, whenever it comes to be imposed. The rates must be certainly lower than in the case of Income-tax.

143. We are in favour of the abolition of the present land revenue system, as it takes no notice of the inability of the small holders to bear it and as its proportionate

incidence has no relation to the principle of ability to bear. Secondly we are opposed to periodical settlements, whether it is once in 20 or 30 years. It is true that Government revenues may suffer heavily by the abolition of the present system. But that cannot be helped. A portion of this possible loss can be made up by raising water-rates by $12\frac{1}{2}$ per cent. or by increasing the area under irrigation, etc.

144, 145, 146 and 147. As we have been urging the need for abolishing the present system of land revenue, we do not propose to offer any detailed replies to these questions which deal with the various aspects of settlements and resettlements of land revenue. Nevertheless, so long as this land revenue assessment is continued, we are strongly of the view that once an assessment is made, there shall not be any resettlement as a whole except for making concessions to agriculturists in view of adverse changes in conditions of cultivation, prices, crop economy.

149. There is no need to discriminate in regard to co-operative holdings.

151. Since only a very small area (i) in rural areas is likely to be used for non-agricultural purposes, not much can be gained by imposing any higher duties. Moreover house-sites ought to be exempted from land-revenue, since house-building in rural areas needs to be encouraged.

152. The existing village revenue staff are over-worked and weighed down by too many duties.

154. For purposes of land cess to provide (i and ii) funds for Local Boards the present system of basing it on land revenue, though regressive can be tolerated, since the conception of annual value is likely to prove to be elusive.

155. (i) We are not in favour of a betterment levy based on the increase in the value of land, as such calculations are likely to be inaccurate. But we do not mind a surcharge on the stamp duty on the sales of lands, which are brought under irrigation or such other special improvement and whose values have gone up appreciately, say by more than 20 per cent.; that too, only after the first five years have elapsed after making the improvements (ii) an irrigation rate or fee has to be charged for the water actually supplied.

(iii) Small compulsory cess within the ayacut can be considered, whether water is utilised or not, only after the first ten years of the new development, so that during the first 10 years, it will not go against peasants while there after it will induce them to utilise water.

156. The very idea underlying the proposal of absorbing for the State, a portion of the increase in land values after the completion of a developmental project is highly retrograde. After all such a project is undertaken not to increase the value of such lands, but as sources of additional employment income and security. Therefore the State ought to think in terms of absorbing a portion of the speculative values of lands before they materialise, which can happen only at the time of actual sales.

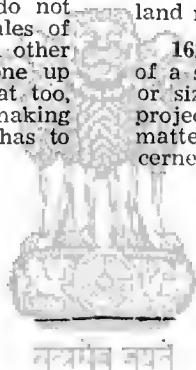
If and when a portion of the realised but enhanced sale values of lands is collected by the state through a suitable surcharge on such realised sale values, such proceeds ought to be ear-marked for the protection, development of the concerned projects and the people of those areas.

157. The irrigation rate may include both an adequate charge for the water (i) supplied and an element of tax but on the whole, the rate ought not to be so prohibitive as to discourage the use of water, (ii) this rate should be based primarily on the area irrigated and the quantity of water needed by specific crops and not on crop value, (iii) no need to revise these rates periodically, (iv) experiments can be made by reducing water-rates on specific crops during the initial stages.

159. Different rates or cesses have to be collected, depending upon the nature of the works, perennial irrigation, tanks, rivulets, tube wells, etc., in relation to local circumstances.

160. It is best not to have any consolidated rate of land revenue.

162. We are not generally in favour of an imposition of a surcharge on irrigation rates based on crop values or sizes of holdings; but for the purposes of financing projects of a local character, it is best to leave such matters to be decided by the society of peasants concerned before the State steps in with its coercive powers.



ASSAM OIL COMPANY, LTD.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION

THIS MEMORANDUM is submitted by the ASSAM OIL CO., LTD., a company engaged in searching for and producing oil and refining, distributing and selling petroleum products in India.

Question 63 :

Should any tax concessions be given to encourage development of mineral resources? If so, what form should they take? In particular, should depletion allowance on wasting assets be allowed? How should it be computed for different kinds of assets you have in view?

1. In our opinion tax allowances should be given to encourage development of mineral resources and in particular to those engaged in searching for and producing oil.

2. It is well known that searching for oil involves very heavy outlays not only in the equipment to be provided, but also in connection with the stores used therein, and the salaries and wages of the trained geologists and their assistants. It is also well known that out of many areas explored it is only in a very few that a concern is successful in finding oil in commercial quantities justifying production therefrom.

Inasmuch as the mineral deposits, from which the oil produced is obtained, are of a wasting nature it is most strongly urged that allowances should be granted in calculating the assessable profits of an oil producing concern so as to compensate the tax-payer for this exhaustion.

Finally the benefits arising to a Country from its indigenous oil production are too well known to require elaboration.

3. The foregoing can be summarised under the following three main headings which are amplified in the succeeding paragraphs—

(a) Allowances for Survey and Exploration including geological, geophysical and drilling expenditure during the period of Survey and Exploration.

(b) (i) Depreciation Allowances on all Capital assets employed in Survey and Exploration and

(ii) an option in the event of closing down to carry depreciation allowances on both surveying and drilling equipment and an allowance for obsolescence, backwards and the right to offset them against previous profits.

(c) Depletion Allowances.

4. Survey and Exploration Expenditure [See paragraph 3 (a)].

The Memorandum referred to in paragraph 6 outlines the treatment accorded to exploration expenditure elsewhere. In India, however, the authorities have some hesitation in admitting as an expense survey and exploration expenditure incurred by an oil producing company in any area before oil has been found there.

It is the view of this Company that since it is a concomitant part of the activities of an oil producing concern to maintain its business (namely its own production of oil) it follows that all costs of exploration and surveying as set out in paragraph 3 (a) as well as

drilling for oil supplies should be treated as normal revenue expenditure except to the extent that it represents Capital equipment.

5. Depreciation and Obsolescence Allowances [See paragraph 3 (b)].

Difficulty has been experienced in obtaining agreement that depreciation should be granted in connection with Capital Equipment utilised on surveys. The Company, therefore, considers that depreciation should be granted in future without question on all expenditure on Capital equipment which is incurred and used in searching for oil.

Furthermore, where an oil company ceases to produce oil through the exhaustion of its mineral deposits an obsolescence allowance should be granted on all surveying, drilling and production equipment then discarded. A situation might well arise where the depreciation and obsolescence allowances in the year of cessation are so extensive that they exceed profits in that last period and in consequence we consider that the loss should be carried backwards, up to a limit of, say, six years and set off against previous profits.

6. Depletion Allowances [See paragraph 3 (c)].

The taxation legislation of other countries grants Depletion Allowances to oil producing concerns since they are engaged in the working of deposits of a wasting nature. The basis of these allowances vary but they are outlined in a memorandum headed "Oil Companies—Taxation Treatment" a copy of which is enclosed.

In the U. S. A. where there are many more oil producing enterprises and with substantially greater oil production, Depletion Allowances are granted of 27½ per cent. of the gross income from the oilfield (with a maximum of 50 per cent. of the net income from the appropriate area) or an allowance is given calculated by reference to the actual cost of the property, whichever is the greater.

In Canada the Depletion Allowance for oil concerns is 33½ per cent. of the net income from production, together with an exemption from taxation of up to 20 per cent. of the dividends paid by the Oil or Mining Companies. In neither case is the total allowance limited to 100 per cent. of cost. In the U. K., allowance is calculated by reference to the cost of past exploration expenditure in the Petroleum Province from which production is obtained.

We would recommend that the depletion allowance should take the form of an allowance calculated on profits from successful production as is granted in the U. S. A. and Canada and that it should not be limited to 100 per cent. of cost.

In this way not only would the inherent commercial risks and the heavy cost which form part of the business of oil production be recognised, but allowances in this form would encourage exploration for further indigenous oil supplies which, where successful, would yield very considerable benefits to the economy of the country as a whole.

MEMORANDUM

OIL COMPANIES—TAXATION TREATMENT

THE ESSENTIAL POINTS GOVERNING TAXATION TREATMENT IN THE U.S.A., U.K., AND CANADA OF EXPLORATION COSTS ARE AS FOLLOWS :

I. DRILLING EXPENSES :

(1) In the U.S.A. Intangible, drilling, and development expenditure ANYWHERE is allowed as an EXPENSE in computing profits, and where this expenditure exceeds oil income of the year it can be set off against any other income of the taxpayer, e.g., Dividends on Investments. Where the expenditure exceeds total income it can be carried forward against future income within the next 5 years.

(2) In the U.K.

(a) The treatment outlined in (1) above applies to all such expenditure which is in the same geological oilfield or structure as that from which commercial production is being obtained.

(b) Drilling expenditure not falling under (a) but with the same Petroleum Province as that from which commercial production is being

obtained is amortised under the "Cost" Depletion allowance for that Petroleum Province.

This treatment also applies to all expenditure incurred in the Petroleum Province before commercial production is obtained.

(c) Drilling expenditure (after 5th April 1952) outside any such Petroleum Province is EXPENSED when exploration in that area is finally abandoned.

NOTE :—For this purpose the whole of Assam/Tripura would (if in U.K.) constitute one Petroleum Province, and would come under (b) but drilling in, say, Cutch would be outside this Petroleum Province and would come under (c).

(3) In Canada. The position here is similar to that in U.S.A., all Drilling costs incurred by a business engaged in production, refining or marketing products

being EXPENSED. Where this drilling expenditure plus geological and other exploration expenditure exceeds oil income it CAN NOT be set off against other current income, but it can be carried forward and deducted from future oil income without time limit.

II. GEOLOGICAL AND GEOPHYSICAL EXPLORATION:

(1) **In the U.S.A.** Geological and geophysical exploration expenditure is EXPENSED when the rights over the areas prospected are sold or abandoned. Where the area prospected is acquired or retained as a potentially productive property the exploration costs form part of the outlay amortised under "Cost" Depletion.

(2) **In the U.K.** This type of expenditure is divided into three categories:—

- (a) that incurred in the same geological oilfield or structure as that from which commercial production is being obtained;
- (b) (i) that not falling under (a) but within the same Petroleum Province from which commercial production is obtained;
- (ii) that incurred in the Petroleum Province before any commercial production is obtained;
- (c) that incurred in other areas outside any such Petroleum Province.

Category (a) is EXPENSED when incurred as in I. (2) (a) whilst (b) is amortised under the "Cost" Depletion allowance for the Petroleum Province. Expenditure under (c) after 5th April 1952 is EXPENSED when exploration in that area is finally abandoned.

(3) **In Canada.** All this type of expenditure is EXPENSED where incurred by a business engaged in production, refining or marketing petroleum products. (See I. (3) above.)

III. DEPLETION ALLOWANCES:

(1) **In the U.S.A.** There are two annual alternative forms of allowance for each mineral property (corresponding roughly to "geological field or structure").

EITHER

- (a) A "percentage" allowance based exclusively on proceeds of oil from the mineral property of 27½ per cent. of value of crude oil at well head with maximum of 50 per cent. net income from crude oil, i.e., value at well head less—

- (i) Drilling costs of that property;
- (ii) Share of general overheads;
- (iii) Depreciation on production equipment but NOT deducting any Drilling costs in other

areas or any geological outlays in abandoned areas.

OR

- (b) A "cost" allowance of that part of the past expenditure on the property not otherwise allowed for taxation, obtained by applying to the unallowed outlays the following fraction:—

$$\frac{\text{production units of the accounting year}}{\text{total estimated future production units from mineral property at commencement of the accounting year}}$$

NOTE:—Where the "percentage" allowance is claimed for any year then the allowance granted is deducted from the balance remaining to be amortised under "cost" allowances, but when these outlays have been fully amortised the "percentage" allowance can still be claimed.

(2) **In the U.K.** A "cost" depletion allowance is granted in respect of Drilling, Geological and Geophysical Expenditure in the same Petroleum Province from which commercial production is being obtained. The amount expensed each year is obtained by applying to the unallowed outlays the greater of the two following fractions:—

production of the accounting year

- (i) total estimated future production from the Petroleum Province at commencement of the accounting year,

or (ii) 1/20th.

(3) **In Canada.** A percentage depletion form of allowance is granted. This consists of 33½ per cent. of the net profits reasonably attributed to the production (as distinct from refining and marketing) of oil or gas.

IV. GENERAL NOTES:

In Canada there are two further special allowances

- (1) A percentage of the dividends paid by an operating Oil Company is exempt from Income Tax payable thereon by the recipient. The exemption varies from 10 per cent. where income from Mining production is between 25 per cent. and 50 per cent. of total income of Company to 20 per cent. where income from Mining production is more than 75 per cent.
- (2) A Special Tax Credit of 30 per cent. of expenditure (Excluding Geological or Geophysical outlays) incurred on drilling deep test wells specifically approved by Ministry of Mines where drilling is unsuccessful.

NOTE.—This allowance is additional to the Company treating the whole outlays as an EXPENSE.

SUPPLEMENTAL MEMORANDUM OF THE ASSAM OIL COMPANY LTD.

1. This Supplemental Memorandum has been prepared in response to a request by the Chairman at the meeting with the Commission which the representatives of the Company attended in Calcutta on Thursday, the 11th March, 1954. At the close of that meeting Dr. John Matthai asked the representatives to lodge with the Commission the Company's detailed proposals in regard to the treatment for taxation purposes of the various matters discussed at the meeting, suitable for the Oil Mining Industry in India.

2. It is the considered view of this Company that in computing the taxable profits of a business engaged in the production of oil or natural gas in India the taxpayer should be entitled to deduct additionally to expenses and depreciation at present admitted by the Central Board of Revenue.

A. In respect of prospecting expenditure

- (a) all intangible outlays (e.g., salaries, wages, consumable stores, etc.) incurred in searching, exploring and drilling for further possible supplies of oil or gas, and
- (b) an allowance for depreciation of all buildings, plant and equipment used in connection with such searching, exploration and drilling at rates to be agreed with the Central Board of Revenue based on the useful life of such buildings, plant and equipment.

NOTES:—(i) We are primarily considering the normal position where the enterprise is actually producing oil such as occurs in our own case. Any capital expenditure on tangible assets, or rights other than the buildings, plant and equipment mentioned in (b), e.g., the capital cost of concessions or of any mining or leasehold rights, etc., would not be deducted in computing profits but would be included in the expenditure ranking for amortisation under the optional Cost Depletion Allowance described below.

(ii) In the case of an enterprise which had not found oil and thus had never yet become a producing company the intangible prospecting expenditure and the depreciation on prospecting equipment would form part of the expenditure ranking for Cost Depletion Allowance. During this period, however an option should be granted such that where the prospecting rights to any area were abandoned then that part of the intangible outlays, etc., which related to that abandoned area could, at the taxpayer's option, be deducted in computing the profits from any other form of income from dealings in oil in the year of abandonment, the expenditure being *ipso facto* excluded from ranking for the Cost Depletion Allowance. When, however, the enterprise found oil and became a producing oil concern, the treatment outlined in (a) and (b) above would be followed.

B. To compensate for the wasting nature of the deposits of oil or gas and to encourage the hazardous and heavy expenditure incurred in prospecting therefor—the producing oil concern should be given in every year the alternative of

EITHER

- (1) A Percentage Depletion Allowance equal to not less than 25 per cent. of the value at the Well-head of the crude oil or natural gas actually produced (as determined for purposes of Government Royalty) limited however to a maximum of 50 per cent. of the net profits attributable to the production of the oil or gas.

NOTE:—The allowance thus represents an incentive based directly on the value of the indigenous oil produced, exempting part of that value from taxation since it is derived from a wasting asset. The overriding maximum limits the allowance to one-half of the excess of the value at the Well-head of the crude oil or gas over the cost of production, exclusive of the cost of

prospecting and drilling for further supplies in other areas.

OR

- (2) A Cost Depletion Allowance equal to that part of the balance of any tangible or intangible expenditure not otherwise allowed for taxation which the total units of oil or gas sold during the accounting year bears to the total estimated units of oil or gas likely to be obtained from the mineral deposits being worked calculated at the beginning of that year.

NOTES:—(i) The tangible and intangible expenditure ranking for this Cost Depletion allowance would initially consist of

- (a) Intangible prospecting expenditure and depreciation on equipment applicable to the periods before any commercial production commenced—less any part thereof allowed for taxation under the optional claim for abandoned areas. See Note (ii) under A above.

- (b) All Capital expenditure on tangible assets and rights for which no depreciation has been allowed or is available—whether incurred before or after commercial production was commenced.

The total expenditure would gradually be amortised as outlined in Note (iii) below.

(ii) The option under (2) would enable an enterprise which incurred heavy prospecting expenditure and then found only a small quantity of oil to deduct annually the correct proportionate part of such outlays in computing its taxable profits.

(iii) In every year after commercial production started the actual allowance granted or the notional allowance due (if the option under (2) was not exercised) would be deducted from the residue of expenditure ranking for allowance to arrive at the balance carried forward for subsequent amortisation.

3. (a) The Company's representatives were requested in this Supplemental Memorandum to furnish evidence in support, or otherwise justify the rates and basis of any depletion allowance they recommended. Whilst it will be appreciated from the information contained in Appendices I and II that the governing factors are such as to render the mathematical justification of any rate impossible, two aspects have an important bearing on the considerations of the rate and basis to be adopted.

One is that any oil produced is the realisation of part of a wasting asset, and the second is that the geographical location, or the geological situation of oil can materially affect the costs of production, and therefore, the rate of profits to be derived in relation to volumes handled.

(b) It is submitted that the experience of Governments and the Industry in other countries where indigenous production of oil is a flourishing business do furnish indications as to what is a reasonable rate. The United States of America and Canada are both countries with substantial industrial and agricultural activity as well as having a large indigenous oil production, and the last mentioned could not have been achieved without the taxation treatment of prospecting expenditure and granting of the incentives outlined in this, and the original Memorandum submitted by our Company.

4. (a) In the United States the percentage depletion allowance is calculated at 27½ per cent. of the value of

the crude oil at the Well-head (ignoring the costs of production), but this allowance is limited to an amount equal to 50 per cent. of the production profit ascertained by deducting from the Well-head value the costs of production, exclusive of prospecting expenditure in other areas.

(b) In Canada the depletion allowance is calculated at 33½ per cent. of the net profits reasonably attributable to the production of oil or gas.

(c) From the point of view of the oil industry, the American method has the merit that the allowance is primarily based on the quantity and quality of indigenous oil actually produced irrespective of the cost of production. Clearly such a basis is more likely to attract the appropriate risk capital and from the Government's standpoint has the definite advantages of linking the maximum allowance to indigenous oil actually produced.

It is clear that the Governments of these two countries have recognised the hazards involved in searching for oil, and that any oil deposits found were a wasting asset, and were convinced that the rates of Depletion Allowances granted provided an appropriate incentive to attract capital to develop a thriving indigenous industry.

It may be added that the Depletion Allowances are granted in the U.S.A. to other extractive industries but these are all at lower rates. The following (which is not an exhaustive list) shows the present rates of Depletion Allowances granted to other industries:—

Percentage of gross Income allowed for Depletion.	Extractive industry
5%	Sand ; Gravel ; Clay ; Granite ; Marble
10%	Coal ; Asbestos
15%	All Metal Mines ; China clay ; Phosphate rock ; Potash
23%	Sulphur

The above percentages accord closely to the geological hazards and risks of the relative industries, and establish that oil is recognised as entailing the greatest risks of all.

The geological risks in India are no less than in Canada and U.S.A. whilst the need for indigenous production in India is more clamant, and unless adequate incentives are provided it is unlikely that capital will be attracted. Moreover the geographical position of India entails much higher outlays for prospecting operations due to the costs of bringing the specialised equipment and stores from overseas and the necessity of maintaining larger stocks thereof.

There is set out in Appendix I a description of the type of Prospecting Expenditure incurred by an oil producing concern and the marked contrast between prospecting for oil and other minerals. This Appendix also contains the grounds for the Company's proposals and the reasons against amortisation of Prospecting expenditure.

Appendix II deals with Depletion Allowances, outlining the grounds for granting this incentive and that it should apply to the whole Industry.

During the course of the Meeting with the Commission a discussion arose on the taxation treatment in America of Intangible Drilling Costs and their relation to the Cost Depletion Allowance available in that country. Appendix III contains some notes on this matter together with a simplified example.

APPENDIX I

Prospecting Expenditure

1. It should be made quite clear at the outset that prospecting expenditure in the oil industry differs markedly from prospecting expenditure incurred in any other industry engaged in extracting minerals such as copper, coal, iron ore, manganese, etc. In the case of other extraction industries the geological possibilities of any area are much more readily ascertainable so that relatively smaller expenditure is incurred before extraction can begin, and the certainty of finding the mineral concerned in commercial quantities is much higher. The difference arises partly from the fact that a solid mineral, once formed, stays where it is, whilst oil migrates from its place of origin for distances measurable in miles until it becomes trapped in some suitable geological formation. It is also due partly to the fact that other minerals are worked mostly from, or within a few hundred feet of the surface, and only exceptionally at greater depths. The search for oil is by contrast the search for a mobile substance which may be 10,000 feet beneath the surface with absolutely no surface evidence to guide the prospector.

Furthermore in the case of oil the areas needing careful survey are enormously greater than the few square

miles in which oil may ultimately be found relatively far greater than the areas that have to be surveyed in prospecting for any other mineral. Moreover even if oil should be found, there is no certainty that its situation geologically, or the quantity found will permit or justify commercial production. Finally the reserves of other minerals are throughout extraction capable of more accurate assessment than is normally ever possible in the case of oil.

2. Although the subject matter of this, and the two following paragraphs were discussed at the Meeting, members of the Commission may wish to have before them a short description of the nature of the prospecting expenditure incurred by an oil Company. This falls into two distinct parts—

(b) The test drilling for possible deposits of oil at localised sites.

(b) The test drilling for possible deposits of oil at localised sites.

3. The geological and geophysical search represents the collection of data by various forms of survey to enable a geological map to be compiled of the manner

in which the rock strata below the surface over the wide area is built up with a view to ascertaining whether it contains places where the structure is in such a form as may possibly contain oil. There can be no certainty that when the data have been compiled they will show that suitable formations exist below the surface justifying the drilling of test wells, and indeed very many individual surveys lead to the result that there is no objective for drilling. In such a case the survey work, which is expensive, yields no return whatsoever. Thus there is no relationship between the amount of expenditure incurred on geophysical searches and the certainty that oil will be found, and as already stated, the surveys are expensive and extend over very large areas.

4. When, however, the data collected show that possible formations exist justifying the drilling of test wells such expenditure is then incurred at these sites, again with no certainty that the drilling will result in finding any oil, or oil in quantities and conditions in which it can be commercially workable.

In certain rock formations a well drilled within, say 500 yards of a successful well, may be "dry" or fail to produce oil in commercial quantities.

Experience in the United States where so much oil has been found shows that 88.9 per cent. of exploratory wells are complete failures; 9.0 per cent. find some oil but nothing of commercial value; leaving only 2.1 per cent. for fields which are commercially workable, of which at least three quarters are however minor fields which do little more than pay for the cost of discovery. This means that in America only one well in 50 finds a workable oilfield and only one well in 200 or 250 finds a fairly large oilfield. These figures are taken from a paper by the wellknown U.S.A. geologist, F. H. Lahee published in the Bulletin of the American Association of Petroleum Geologists for June, 1953, vol. 37, No. 6, pages 1193 to 1210.

The U.S.A. discovery rate may be taken as representative of the conditions in most of the World including India, but it should be added that the Persian Gulf area is an important exception. The success ratio in that region has so far been much more favourable to the prospector and the geological evidence points to vast reserves of Middle East oil being available for production. This factor may tend to operate as a potential deterrent to prospecting in India and other areas.

APPENDIX II

Depletion Allowances

1. It is recognised that, if the taxation treatment of prospecting expenditure outlined above is accorded, the granting of a percentage depletion allowance represents largely a taxation incentive.

2. The grounds for the granting of such an incentive are:—

(a) The prosperity and well-being of any nation and the ability of such a nation to strengthen its economy and maintain or raise the living standards of its population can be very largely affected by the successful and continuous development of its natural resources.

(b) Owing to the importance of petroleum products in world trade, the development of any crude oil or natural gas forming part of its own natural resources can form a very important factor towards the improvement of a country's economy.

(c) Oil, however, has not only to be discovered but, having been discovered, has to be extracted from the earth. The searching for and finding of oil involves much heavier and more hazardous expenditure than for any other natural resource. As even on test drilling alone there is about one chance in thirty of finding oil or gas in commercial quantities, it follows that the large sums of money necessary will only be obtained by attracting new capital, or by encouraging the application of profits from existing indigenous production to this end.

(d) Even when an oilfield is discovered, whatever the extent of the deposits, production difficulties can be encountered curtailing the period of commercial operation such that the money spent on prospecting may not even be recouped. The Badarpur oilfield in Assam was worked for 18 years until it was exhausted, but no profit was made.

(e) Because the risks involved in this search are so substantial it is obviously in a country's interest to attract capital and encourage the application of profits within the industry to further prospecting. Experience does not show that the allowance of prospecting expenditure as a deduction in computing tax-

The conclusion to be drawn is that if allowance is made for the discovery of both oil and gas, it is a fair presumption that 1 well in 30 will on the average find an oilfield or a gasfield which is workable (although more often than not the field is but a small one). Thus, even in a country like America with a long history of oilfield development and wealth of experience, the odds are heavily against a test well being successful.

5. The foregoing establishes the absence of any relationship between the amount of exploration expenditure and the discovery of oil which contrasts markedly with the position in any other extractive industry. Such expenditure, however, represents the search for the raw materials of the Company's business. Normally where expenditure is incurred, after a business has commenced, in seeking and obtaining stocks of raw materials, such outlays are a proper deduction in computing profits even if they should involve a comprehensive organisation for the purpose. The Company, therefore considers that, as these outlays are clearly expended in the normal course of its trade, the case for treating all such intangible expenditure as a revenue expense, as and when incurred, is overwhelming.

By the same principles depreciation is properly and clearly allowable on the capital equipment used in connection with the searching and drilling for further supplies of the Company's raw material.

6. It was suggested during the discussion with the Commission that prospecting expenditure of a producing concern might be amortised either over a certain period of years or over the period of production. The previous paragraphs, however, show clearly that with no certainty that such expenditure will find oil it would be unreasonable, and in fact be a disincentive for the amortisation to be given over a period of production which may never materialise. Nor is amortisation over a period of years considered reasonable in the case of the oil industry having regard to the nature of the outlays. The prospecting expenditure would appear to be analogous to Scientific Research (*vide* Section 10 (xii) and (xiv) of the Income Tax Act) and since the intangible outlays claimed do not include any capital equipment or rights they should be treated as an expense as and when incurred, the capital equipment being depreciated as already mentioned.

able profit: is of itself sufficient to encourage the substantial expenditure necessary if the potential benefits outlined in (a) above are to be achieved. It is only by creating fiscal conditions in which those bearing the risks of searching for oil will be entitled to a return after taxation adequate for their investment that is achieved. With present high rates of taxation this can be made possible by granting of special allowances free of tax to the oil industry. Otherwise overseas oil companies will tend to invest their capital, or apply their profits in prospecting in those countries where additional incentives are granted, limiting investment in India to Refineries and Distribution assets to handle imported oil products.

(f) The Governments of other countries, notably the United States of America and Canada (which together produce 53 per cent. of the World's production) recognising the enormous advantages to be gained from a thriving indigenous oil industry and also the desirability of encouraging the expenditures necessary to achieve such a position have by varying methods accorded appropriate treatment of this expenditure and have granted definite incentive allowances for taxation purposes.

3. The foregoing shows that the depletion incentives are claimed partly on account of the wasting nature of any oil found, and partly on account of the heavy and hazardous expenditure in searching for oil.

Clearly therefore the taxation incentives for the oil industry should be the same for all concerns, all areas and all production. The hazards of prospecting for oil are such that there can be no finality in any assessment of the position for any area. Differentiation could result in encouraging exploration in areas where no commercial oil may actually exist at the expense of other areas where undiscovered oil may actually lie or of oilfields requiring development. Regard must be had not only to the possibilities of discovering commercial oil in an area but to the cost of discovering, producing and of transporting to the nearest available market any oil found; these costs vary widely and unpredictably between one oil field and another and a system which could result in the grant of depletion allowance to a

cheap oilfield whilst denying it to a costly one would clearly be unsound. Again the granting of such allowances to one oilfield and not to another may encourage the taking of a higher production from the one at the expense of the other; an established oilfield might be abandoned earlier if it did not receive the allowances.

Differentiation could thus result in the loss of available oil resources. Any suggestion of discrimination between competitive interests in the industry has been avoided in the U.S.A. and Canada and here again it is felt that the methods and successful experience in those countries provide the surest guide to sound practice.

APPENDIX III

Taxation—Treatment in America

1. During the course of the discussion reference was made to the taxation treatment in America of Intangible Drilling and Development costs and their relation to Cost Depletion Allowances. The following notes and example as to the position in America may be of assistance to the Commission.

A. Depletion Allowances

- (1) The taxpayer has the option in any year to select either
 - (a) the Percentage Depletion Allowance or
 - (b) the Cost Depletion Allowance for each mineral property.
- (2) The Percentage and Cost Depletion Allowances were described in detail in Section III of the original Memorandum submitted to the Commission. The Percentage Allowance has again been described in paragraph 4(a) of this Supplemental Memorandum, whilst the Cost Depletion Allowance represents an allowance for that part of any expenditure on the property charged to capital account which has not otherwise been allowed for taxation. The annual allowance is calculated by applying to the unallowed outlays the fraction which the units of production sold in the accounting year bears to the total units of production estimated from the mineral property as at the commencement of the accounting year.
- (3) Where he selects the Percentage Depletion Allowance, i.e., (1) (a) above, the Cost Depletion Allowance that would be available to him for that year is deducted from the residual balance of expenditure to be allowed under (1) (b) in subsequent years.
- (4) Where the residual balance under (1) (b) is exhausted so that no further Cost Depletion Allowance is due the taxpayer can still continue to claim Percentage Depletion Allowance.

B. Intangible Drilling and Development Costs

- (1) These consist of such outlays as: wages, fuel, repairs, hauling supplies, etc., incidental or necessary for drilling wells or preparing wells or preparing wells for production, including clearing of ground, draining, road making and surveying.
- (2) The taxpayer can elect to deduct this expenditure as an expense in computing his profits in the year in which it is incurred, or, alternatively, he can charge it to Capital Account along with any other capital outlays spent on the mineral property when the expenditure is amortised under the Cost Depletion Allowance.

This option, however, is not an annual one and the first election is binding for all subsequent years.

- (3) If the taxpayer elects to charge the expenditure to Capital Account he has an additional option available, namely, that he may treat the intangible Drilling and Development costs of any non-productive oilwell as an expense in the year when the well is completed.

If this further option is exercised it is binding for all subsequent years.

The optional treatment to charge Intangible Drilling and Development Costs to Capital Account is quite independent of the Percentage Depletion Allowance option. Thus a U. S. taxpayer who has elected to deduct this expenditure in computing his taxable income can in any year also obtain the Percentage Depletion Allowance upon crude oil produced and sold. This is the

normal procedure where the taxpayer has income to absorb both claims.

Where however, the taxpayer has either no, or insufficient income to cover such claims he may well elect to charge the Intangible Drilling and Development Costs to capital, and so amortise them over a number of years through his Cost Depletion Allowances. It will be borne in mind that the taxation benefit from any Loss which is created through claiming the Intangible Drilling outlays as an expense is only available for 5 years from the date when the loss was sustained.

2. The following simplified example may outline the position more clearly—

Assume (1) (a) The taxpayer has elected to treat all Intangible Drilling and Development Costs as Revenue Expenditure.

(b) The unamortised balance of Capital Costs of the Mineral Property are \$50,000.

(2) (a) His proceeds from the sale of the Refined Oil Products for the year were \$150,000

(b) The value at which the relative crude oil would have been sold as crude at the oil field to be \$60,000

(c) The amount of oil produced during the year to be 10,000 units.

(d) The total potential production from the mineral property estimated at the beginning of the year to be 100,000 units.

(3) The production Expenditure and Intangible Drilling and Development Costs of the Mineral Property (including Depreciation on Equipment) \$30,000

(4) The Intangible Expenditure on Prospecting and Test Drilling in other areas (including depreciation on Equipment) 20,000

(5) Expenditure on Refining and Marketing (including Depreciation) 30,000

(6) General Expenses & Overheads 15,000 95,000

Gross taxable profit \$55,000

Depletion Allowances

Either (A) Cost Depletion Allowance
10,000 (Units produced) (2) (c)

100,000 (total estimated production
(2) (d) of \$50,000 (residual
balance of capital costs of Mineral
Property, etc. (1) (b))
= \$5,000

or (B) Percentage Depletion Allowance—

(a) 27½% on value of Crude (2)(b)
\$60,000 \$ 16,500

(b) Production Expenses (3) ... \$30,005
Proportion of General Expenses
(6) say ½ ... 7,500 37,500 } 11,250

50% of net Profit \$22,500 11,250

Net Taxable profit ... \$ 43,750

THE AHMEDABAD MILLOWNERS' ASSOCIATION, BOMBAY

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART I.—THE TAX SYSTEM

GENERAL.

Question 1.

In a country with a low national income, the supreme objective of economic policy should be to effect a rapid rate of economic development. Naturally the tax policy also should be tuned to this general objective. In the democratic frame-work of a mixed economy, rapid development can be achieved only through maximum incentives to private savings and investment and to private enterprise. The public sector is only complementary to the private sector and should assume responsibility only in those spheres which are beyond the scope of private enterprise even after the provision of maximum opportunities. Therefore, among the four objectives stated in the question, viz., (a) reduction of inequalities of income and wealth, (b) encouragement of incentives to work, to save and to invest, (c) countering of inflationary and deflationary tendencies and (d) maintenance of the external balance of the country, the objective (b) is of primary importance in an underdeveloped country. The other objectives are only incidental to this.

While the social injustice caused by income and wealth inequalities should not be lost sight of, it is equally important to realise that any equalization of income in an underdeveloped country merely results in increased consumption and thereby further reduced the volume of saving which is already low. Any such policy would hamper capital formation and make the nation poorer.

Tax Policy should not be the major instrument of countering inflationary tendencies. In an underdeveloped country, any developmental spending is bound to create inflationary pressures on certain markets which are faced with real shortages. Taxation as a means of countering this would be undesirable since it would destroy the incentive to develop. What is desirable in such cases is judicious and selective controls.

In times of deflation, however, to the extent that this tendency is aggravated by taxation, tax reliefs and tax withdrawals would be highly effective in checking such a tendency.

Maintenance of the external balance of an economy, though by itself an important problem, can only be a minor objective of tax policy. Quantitative trade controls and exchange control are deemed to be the appropriate and effective devices to maintain the external balance.

In the light of the above discussion, the urgent need for modification of the Indian tax system becomes apparent. In the Five Year Plan of India, only 8 per cent. of the total public outlay is denoted to the industrial sector and the task of industrialisation is predominantly left to private enterprise. It is, however, evident that the private enterprise has so far not been able to contribute its mite fully in this direction. This is to a large extent due to the unhelpful Government policy. In our opinion, the private sectors can accept the above responsibility only if proper incentives are created. The important modifications in the tax system necessary for this purpose are:—

- (i) Relief in the rates of personal income taxation, specially at higher levels of income, since they are acting as a deterrent on work, saving and investment.
- (ii) Reduction in corporate taxation particularly with regard to taxation of undistributed profits, with a view to encouraging corporate savings and investment.
- (iii) In respect of plant and machinery installed by a Company particularly prior to 1948, revaluation should be permitted so as to assess the correct replacement value and additional depreciation should be permitted on the basis of this revised valuation so as to create a reserve fund on the basis of our reply to Question 61.

Questions 2 and 3

The concept of equity of a tax system refers to the distribution of the tax burden among the various sections inside a country. The idea is that the tax burden should be distributed in an equitable manner among the different groups, that the rich should pay more than the poor. The concept of equity, however, comes into its own only in highly developed economies. In under-developed countries aiming at high rate of

development it is difficult to reconcile this objective with the ideals of equity. For if the higher income groups are given free incentive to expand production and the lower income groups contribute their mite, the size of national income goes on enlarging and there is more for every one. Unequal distribution of riches is definitely more desirable than equal distribution of poverty. But this does not mean that there should be no balance in the distribution of burden. The point to note is that the higher income groups should not be unduly taxed just to satisfy the ethical ideals of equity.

With regard to the Indian tax system it is difficult to arrive at any precise statement in the absence of a thorough study of the incidence of taxation on the various groups inside the country. But one can confidently state that direct taxation forms a larger percentage of the total taxation than before and the progression is also unduly steep. For instance while in 1938-39, income and profit taxes constituted 11 per cent. of the total in 1949-50 it was as much as 24 per cent. Equity is being enforced beyond the reasonable degree. Again, the distribution of the tax burden between the urban and rural groups is by no means equitable. While the urban sections are taxed sometimes beyond their ability, the rural area is very lightly touched. There is, therefore, need for taxation of agricultural income to repair this injustice. Further, unless the rate of progression is scaled down and the reliance on direct taxes reduced it would be extremely difficult for private enterprise to play their role in the development of the country.

Questions 4, 5, and 6

Taxable capacity is a term which has been subjected to varied interpretations and therefore any comment on the taxable capacity of a society has to be prefaced by the exact meaning we assign to the term. It would be helpful, however, if we tackle the pragmatic question whether there is scope for additional taxation in this country.

It is no doubt a fact that the proportion of tax revenue to national income is low in India. But that is because the country is poor. The proportion depends, among other things on the economic structure, tax consciousness and the quality of the administrative personnel. A predominantly agricultural country with inadequate development of market mechanism cannot provide ready sources of taxation. Moreover, a sizable part of tax proceeds in advanced countries accrues from foreign trade. But foreign trade accounts for a very small part of India's national income.

A major source of taxation which has not so far been exploited is the agricultural sector. With the World War II and thereafter, there has been a phenomenal rise in farm incomes. At present with the existing rates of land revenue, this sector is only very lightly touched. No time should therefore be lost in levying taxes on agricultural income.

There is at present a disproportionate reliance on direct taxation in this country. As already pointed out, in 1949-50, nearly 24 per cent. of the total tax proceeds consisted of taxes on profit and income while an overwhelming majority of the population are below the exemption level. In a developing economy this is extremely undesirable. Unless substantial relief is given in taxation of profits and income, there is no likelihood of any drive on the part of the private sector.

It is extremely important to realise that in a country like India, with a population of 360 millions, the most fruitful source of revenue is indirect taxation. Taxes on commodities and service, however small they are, yield enormous revenue because of the huge turnover. There is a strong case for reducing the reliance on direct taxation and increasing the reliance on indirect taxation in our country, from the point of view of incentives to private enterprise, as well as from the point of view of yield.

Sales taxation on primary commodities and manufactured goods comprising necessities should not be carried too far. In fact in some States, it is already too high. But there is certainly scope for taxation of public utilities such as supply of water, electricity, transport, entertainment etc., which have an inelastic demand. Though such taxes are regressive in character and therefore unjust, in the long run these adverse effects would be more than outweighed by positive benefits. There is of course quite a strong case for heavy taxation of luxury consumption such as automobiles, frigidaire, radios, etc.

Question 7

The answer to this question depends upon the future policy towards nationalisation of the Centre and the States. The present size of the nationalised sector is

fairly small. And the avowed policy of the Government so far has been to nationalise only the key and strategic enterprises and those undertakings which are beyond the competence of the private sector and yet occupy a vital place in the economy, such as hydro-electric power generation. Such enterprises, have a case to be subsidised rather than turned into revenue gatherers in the broader social interest. Hence there is no likelihood of non-tax revenues being substantial in the near future.

Questions 8 and 9

Taxes, by definition, are different from receipts that conform to *quid pro quo*. The principles that guide taxation have little to do with principles that govern public expenditure. But purely from tactical point of view, it is desirable in some instances to levy taxes earmarked for specific purposes. Such a linking is profitable if it produces a psychology in the mind of the tax payer what he so ends is of direct benefit to him. For example irrigation rates and betterment levies. In cases where, however, there is no such linking and a cess is levied on one industry for the benefit of another industry such a levy is most improper and inequitable. The levy of Handloom cess on mill-made cloth for the benefit of the Handloom industry is an example of such a levy. My Committee are strongly opposed to levy of such a type of cess.

Questions 10 and 11

Public undertakings should contribute to the State both in the form of interest payment on capital made available and in the form of taxes, just as any private enterprise is expected to pay. If after the payment of such contribution and after provision for depreciation, surplus funds are left with the enterprise, such funds should be allowed to be utilised for reinvestment and expansion of these enterprises, unless further expansion of this one is socially unnecessary. Only when there is no scope for re-investment, should the funds be made available to the State either in the form of interest bearing loans or repayment of borrowed capital, which may be utilised for financing development. Such a policy would create the necessary incentive to the enterprise to operate in an economical and efficient manner.

Pricing of public undertakings should conform to the same criteria as the fixation of prices for private manufacturers are subject to by the Government. As mentioned earlier, public enterprises are not generally intended to be revenue gatherers. Moreover the Industrial policy statement of the Government does not visualize nationalisation for revenue purposes only. Any deviation from this policy would be of detriment to the community.

INCIDENCE OF TAXATION.

Question 12

In view of the structure of the Indian Economy, it would be most advantageous to examine the incidence of taxation with reference to rural and urban residence, or to be more precise, agricultural and non-agricultural groups. Of course within this main division, there should be further sub-grouping according to income. The classification should facilitate the evolution of a tax system in which the incidence is the same on similar income groups whatever their residence or occupation. With the levy of estate duties, the differentiation of earned incomes from unearned incomes also becomes important.

Question 13

(a) There is sufficient ground to believe that the distribution of the tax burden is adverse to the higher income groups. These groups are contributing much more than their legitimate share as compared with the middle and low income groups. Further, even among high income groups, the urban section comprising the industrialists and traders are taxed very much more than the rural rich consisting primarily of land owners. However, in the absence of a detailed study of tax burdens based on family budgets, it is difficult to assess the exact degree of injustice.

This excess in taxation of the urban higher income groups is of great detriment to the economic welfare in the long run. There is an urgent need to redistribute the tax burden such that the rural elements bear their due share, and thus relieve the pressure on the entrepreneur.

(b) The discrepancies indicated above have naturally their undesirable consequences on the distribution of tax burden among the States. States which are industrially advanced and enjoy flourishing trade and commerce and have a larger urban population, like Bombay are subject to much greater tax burden than the relatively backward States where agriculture alone is the major source of income like Assam and Orissa.

Question 14

The shifts in the distribution of income in the community in recent years have definitely altered the relative incidence of taxation on various classes of

people. It would be useful to study the shifts of two broad types:

- (1) those within the urban and rural areas, and
- (2) those from the urban to the rural areas.

With regard to the first, there is some reason to believe that the urban working class have benefited a higher percentage rise in money income than the rich, whereas in the rural areas, the land owning class have benefited at the expense of the landless labour. But inside the urban areas, the steeply progressive income tax coupled with sales tax have ensured that the upper income groups bear larger burden. There is no similar redistribution of tax burden in respect of shifts in rural incomes. For, in the absence of agricultural income taxation, the rural income earners are hardly affected by the tax system since their only major tax, viz., land revenue has remained static over a long period and bear no parity whatsoever with taxation of similar earnings in other spheres.

Question 15

In quite a few cases of taxation in India, the cost of compliance with tax regulations adds materially to the burden of taxation. This is particularly so in the case of medium and small enterprises where detailed accounts have to be maintained in a specified form, for purposes of income and sales taxation. This calls for considerable additional expense. In the case of some industries subject to specific excises the compliance with the excise duties is an additional item of expense. To some extent this cannot be helped. But the net tax yield out of such sources should be sufficiently large to justify the large cost of compliance. There is one more point to take note of. In many cases of income and sales taxation, even though the gross yield is considerable, the cost of tax administration is so heavy as to make the net yield unimpressive. This results in poor returns to the State in spite of heavy burden on the tax payer. It is urged that in reforming the tax system it should be borne in mind that both the cost of compliance with regulations on the part of the tax payer and the cost of tax collection should be reduced to a minimum.

Question 16

The benefits accruing from public expenditure have certainly a bearing on the consideration of the burden of taxation. With the modern forms of public expenditure of a welfare State the higher income groups mostly bear the heavy burden of taxation.

Question 17

In the case of the cotton textile industry the burden has been excessively heavy. In addition to income tax, super-tax and corporation tax, various other taxes, viz., Excise Duty, Import Duty on Cotton and other Stores, Export Duty on Cloth, Sales-tax, Electricity Duty, Urban Immovable Property Tax, Local Property Taxes and Octroi Duty are imposed on the Textile Industry which has considerably put up its cost of manufacture.

TAXATION AND ECONOMIC DEVELOPMENT.

Question 18

The most important problem of developmental finance in an under-developed country is to arrive at the right proportion between taxation and borrowing as means of mobilising finance. It is the essence of mixed economy that there should be maximum incentive to work, to save, and to invest. Therefore, progression in direct taxation should be as low as possible and for all developmental spending borrowing should be preferred to taxation. For with the completion of the projects, it should be possible to price the goods and services at a rate which makes payment of interest and capital easy and smooth. Financing projects out of taxation would mean a disproportionate sacrifice on the part of the present generation for the continued and growing benefit to the future generations.

In the light of the latest experience, prospects of public borrowing appear to be considerably bright in the country. The response to the various State loans has been enthusiastic and this should enable the Government to reduce the dependence on taxation gradually and increase borrowing. It should be stressed in this context that Government commands a wider area and greater means for this purpose through their small savings campaign, national savings certificate, postal savings, and so on. Therefore, it would be appropriate for the Government not to impinge on the organised capital market which is the only avenue open to private enterprise but widen its drive in mobilising small savings as well as rural savings. In this manner without marring the prospects for private enterprise, the State could mobilise a larger volume of savings of the community.

While the resort to progressive direct taxation is objected to, it does not mean there should be no indirect taxation. There is considerable room for increasing indirect taxes through care should be exercised in not raising the cost of living.

Question 19

The above observations have made it clear that there is no room for (c) and (d) that is, higher rates of existing taxes and development of non-tax revenues. With regard to (d), viz., fresh taxes the rural sector is a field which may be exploited. Even in the urban areas there is scope for widening the coverage of indirect taxation. But (c) viz., economy and rationalisation in expenditure calls for immediate and serious attention. There is a considerable amount of wastage in public expenditure and the country is familiar with quite a few 'scandals'. If this is checked there will be more funds available for development or for reducing the tax burden. If the authorities in charge of the administration of tax laws adopt a more human approach towards the assesses, it would reduce the chances of evasion and enhance the revenue. The necessity of bringing about better relations and understanding between these two important elements in the Society are long felt and the Government should take urgent steps to bring about the same.

Question 20

This question has already been answered in the course of our discussion of Question 18. The tax policy should be such as to provide maximum incentive to free enterprise. There should be a minimum progression and greater coverage of indirect taxation.

Question 21

Tax Policy need not be employed to regulate capital formation in the private sector in order that it is consistent with the needs of the public sector. If the Government desired to stimulate particular lines of capital development, this may be achieved by tax concessions and subsidies in addition to other forms of help.

Question 22

(1) Estimates of capital formation in this country are not reliable. It may, however, be stated that in the organised industrial sector, there have been some amount of replacements, renewals and expansions of the capital equipment which was worn out during World War II. But the rate of capital formation would have been much more spectacular if the Government had adopted a more liberal policy, towards taxation. It has been estimated that in order to provide for replacement of equipment, the industry today has to earn a sum of gross profits nearly eight times the sum necessary in the immediate pre-war period.

(2) The bulk of savings at present come from corporations and institutions which are in a special position to save rather than individuals.

Question 25

There is hardly any scope for any restriction of the existing consumption standards since the mass of the people just have the irreducible minimum. The problem really becomes important with the rise in national income brought about by the fulfilment of the Five Year Plan. Care should be taken not to dissipate this increase in income by increased consumption. Because such a policy would retard the pace of development. But this restriction of consumption should not be attempted through the imposition of direct taxes. Indirect taxation coupled with judicious and selective controls over essential commodities should be adequate for this purpose. Import control and heavy taxation of luxury consumption would be of additional help.

Question 26

The role of tax policy in raising the efficiency of the economic system is mainly negative. Greater the tax concession higher the incentive to work, save, and invest.

The multiplicity of tax system in India has definitely done harm to the efficiency of the productive system. This is particularly true in the case of sales tax. There is an urgent need for centralisation and standardisation of sales tax rates in India. Perhaps to adopt such a procedure the Central has to assure the States that their individual share will not be radically smaller than what they are enjoying under the present system.

Question 28

Tax Policy in general must have the effect of reducing the overall demand of the community (excluding the Government demand). In our country with respect to majority of the population, taxation does reduce consumption. Only with regard to the higher income groups does taxation act as a disincentive to save? A differential tax system may promote desirable investment and check the undesirable. Taxation with a view to redistributing income in favour of the lower-income groups would do positive harm to the nation's economic development.

Question 29

In the planning of development in a mixed economy tax policy contributes an integral part of the economic policy, among the other components of which are the monetary policy and direct controls. A liberal tax policy with greater stress on indirect taxation together with a liberal monetary policy of credit expansion and low

interest rates would create buoyant conditions in the capital market and set a healthy tone to the entire productive system. There would be a sense of optimistic enthusiasm prevailing the economy. It is feared by some that such a situation entails inflationary consequences. But a judicious and selective policy of direct physical and price controls would keep in check any such tendency.

Question 30

The present tax system in India does make for a reduction in inequalities of income and wealth, because the rate of progression is very steep. Detailed statistics are not available to measure the rate at which the inequalities are being reduced.

Question 31

There can be no answer to Question 31 because, as we have just now pointed out, in a poor country aiming at rapid capital formation and improvement in productive efficiency, tax system should not attempt to introduce any measures of reducing the income of the entrepreneur. There is considerable scope for raising the standard of living of the lower income groups without resorting to taxation by means of public expenditure financed out of borrowing or deficit finance, with appropriate controls.

Question 32

Wise public expenditure can produce the healthy effect of improving the productive efficiency and raising national income. Expenditure on extension of free education, medicine and public health, industrial housing etc., belong to this category. Such measures while raising the minimum standards does not adversely affect the high income groups. On the contrary it benefits them too. Public expenditure of this type is not merely remedial but curative.

Question 33

The present policy of non-discrimination is quite fair and, therefore, we do not recommend any changes. But what we suggest is that there should be selective flow of foreign capital that is, foreign capital and enterprise should enter only those spheres which are beyond the capacity of Indian capital and enterprise and should not compete with the latter.

Question 34

The possibilities of adding to the country's tax resources of the various items enumerated in the Question are to be judged keeping in view whether such additions would prove beneficial or harmful to the country's economy.

- (a) and (b) The Parliament has already passed the Estate Duty Bill which in our opinion, would kill the incentive of the business community for future progress. Succession Duties will also have similar effect and are therefore, not suitable for our country.
- (c) Heavy Octroi Duties have already been imposed by Local Authorities. In our opinion, therefore, there is no scope for terminal taxes.
- (d) Railway Fares and freights are already very high and no additional tax should be levied on the same.
- (e) No other tax excepting stamp duty should be levied on transactions in stock exchange and future markets.
- (f) There is no scope for tax on sale or purchase of newspapers, but the advertisement published in the same as well as elsewhere may with certain exceptions be taxed moderately.

Question 35

We favour the reintroduction of salt duty, surcharges on land revenue, betterment levies, agricultural income tax and modification of the policy of prohibition. Salt duty is a pre-eminent indirect tax which is highly productive though its incidence on the tax payer is almost negligible. Moreover, when the Government has accepted the principle of taxing necessities and duties are being imposed on sugar, matches, etc., there is no reason why there should be delay in re-introduction of salt duty at a low level. The surcharge on land revenue is recommended in the light of the shift of incomes in the recent years in favour of the land owning class. Agricultural income tax is a counter part of urban income tax. We have already pointed out that equal levels of income should be subject to equal taxation whatever their residence or occupation. Agricultural income tax ought to have been introduced long ago. Betterment levies are only a natural application of the principle that a person who derives benefit from external sources should surrender part of his benefit. Capital taxes are, however, extremely undesirable and will have a damping effect on the capital market which is already sagging. Social security taxes will be a further burden on the industrial class who are already over-burdened.

Question 36

It is desirable to levy a tax at a very moderate rate on unearned increments in value of land and other property as a result of public projects of development.

Question 37

We have already discussed this question in the course of our previous observations. To summarise scaling down of progression in income-tax, simplification and elasticity in the procedure of tax collection, and wider coverage of indirect taxes which do not seriously upset the cost of living and raise the price of primary commodities are the measures we suggest.

Question 38

With respect to the imposition of new taxes, our answer to 35 covers the entire ground.

Question 39

There is no scope for the centre to impose surcharges as already the direct taxes bear too heavily on trade and industry. The surcharge that is levied at present should be withdrawn at the earliest.

Questions 40 to 45

We have partly discussed this problem in our answer to Question 1. Direct taxation as an instrument of countering inflation is risky. Such a policy would curb the incentive to save and to invest. Because of basic shortages in India, developmental spending is likely to create inflationary pressures over a few markets. But this could be held in check by judicious and selective controls. Taxation of luxury consumption may be resorted to if necessary.

With regard to deflationary tendencies, however, tax reliefs and tax withdrawals are bound to prove effective in arresting any drift towards recession and unemployment.

In respect of the taxes listed in Question 41, none of them is necessary from the view point of countering inflation. But relief in direct taxes, excise duties, export duties and sales-tax and increase in import duties on luxury articles do help in checking deflationary tendencies.

PART II.—DIRECT TAXES**INCOME-TAX****Capital Gains.****Question 48**

Imposition of capital gains under a fiction of law inhered in Income-tax Act is basically wrong. Whatever may be the merits or otherwise of taxing capital gains, it must be done through a separate Act. Capital gains may be a species of income, but Income-tax Act deals with the only single species known as revenue income—as opposed to capital income. If capital gains are subjected to tax when they arise, there would be a double tax burden if these are, as they must be, again subjected to Estate Duty. Capital gains tax has rightly been repealed and it should not be revived in any form again.

Foreign Profits.**Question 49**

Taxation of profits accruing to a resident abroad may be a fit subject of taxation, but the administration of the law as regards foreign income and recovery of tax are made difficult by the following circumstances:

- (1) financial embargo on remittance;
- (2) absence of double Income-tax relief;
- (3) a person may attract double ordinary residence both in India and abroad;
- (4) manner of calculating income artificially under two Acts may differ in quantum and relief is granted only on the lower of the two amounts;
- (5) payment of taxes at both ends may amount to a figure more than the income itself unless relief is granted by the authorities;
- (6) prompt collection of tax by deduction at source, advance payment, provisional payment and final payment all make a deep inroad on man's capital, while his refunds and computations of losses are inordinately delayed.

In case of nationals wishing to settle down in India, foreign accumulated savings brought into India should not be taxed even if such a person technically attracts the status of a resident in the year of his arrival. These incoming sources of capital should be encouraged by making them tax-free. Further, realisation abroad of capitalised income with a view to bringing it into India should not be deemed to be income. Such capitalisation should be recognised, unless there is a reasonable doubt as to the *bona fide* of the transactions.

Business Connection.**Question 51**

The terms of Section 42 are wide enough to catch within its taxation net not only trading in, but also trading with India. The latter category of transaction under most tax systems of the world are never taxed but in India, it is otherwise. It discourages foreign connections and imposes unfair burdens on the residents for the transactions.

We would suggest that this Section should be amended on the lines of the English Act, basing the liability on the principle of trading in a country as opposed to trading with a country. The latter category of transaction of the non-resident should not be subjected to tax.

Questions 52, 53 and 54

We have already stated in course of replies to Part I that Agricultural Income-tax should be levied.

Fluctuating Incomes.**Question 55**

Fluctuating income is a species of income and from the point of ability should not be regarded as income which creates a regular source for the assessee. The source may yield irregular income, but the source must exist. So long as the source exists, any yield from it should rightly be regarded as income and taxed. But this is not true with regard to isolated, non-recurring receipts. The question of taxing the income on average basis will involve a review of past years' assessments which may not be administratively easy to carry out. Similar difficulty is likely to confront the spreading of receipt over a number of years.

Section 12AA and Section 60(2) of the Indian Income-tax Act having recognised the principle of spreading over a period of years under the head salary or income of irregular and fluctuating nature suggests that some general provision should also be enacted which would enable the income from accumulated Preference Dividend to be spread over the years to which they relate not exceeding four.

Similar provision is also necessary in connection with the spread over of the compensation, gratuity and such other lump sum payment received on termination or retirement of services.

New Industries.**Question 58**

Concession given under Section 15C must continue. Any depreciation allowance each year should be reduced by the profits, if any, made by such undertakings and allowed to be carried forward next year and so on, just like any other assessee.

Life Insurance and Provident Fund.**Question 60**

In respect of life insurance abatement, the present restrictions are reasonable. But in order to induce this type of saving in the lower grades of income, the present one-sixth should be advanced to 1/4th up to the total income of Rs. 15,000, 1/5th up to Rs. 25,000 and 1/6th thereafter.

ALLOWANCES.**Depreciation.****Question 61**

With regard to depreciation allowance, it is felt that the present method of allowances, initial, normal and extra allowance and double shift allowance—seems to adequately cover the wear and tear loss suffered by the Company. In respect of Plant and Machinery installed by a Company particularly prior to 1948 revaluation should be permitted so as to assess the correct replacement value and additional depreciation should be permitted on the basis of this revised valuation so as to create a reserve fund to be utilised in future for the replacement of such machinery. Such depreciation should be allowed as an admissible expense. There should, however, be certain conditions attached to this relief, such as—

- (1) the funds shall be ear-marked only for replacement of Plant and Machinery;
- (2) the funds shall not be utilized for distribution as dividend;
- (3) if meanwhile, there is a liquidation of the company, these funds shall be treated as profits in the hands of the liquidator.

Classification of Assets.**Question 62**

As compared with machinery, depreciation rate on furniture needs to be adequately increased so as to compensate this class of assets for the loss of initial and extra depreciation allowances allowed to the former.

Admissible Expenses.**Question 65**

The present law is defective as regards admissible allowances in several ways. It does not recognise

expenses which are purely business expenses (being neither personal nor capital) and such as would not have been incurred but for the fact that the assessee was carrying on business. These should be allowed provided they are proved to be revenue, not personal or capital, and incurred for the present or future advantage of business. With the very high rate of tax, the question of approximating the true taxable income to the real income of the assessee has assumed a very great importance. Expenses of the following nature should be allowed:

- (1) entertainment expenditure on business,
- (2) travelling expenses to foreign countries,
- (3) (i) legal expenses in civil suit arising out of business transactions should be allowed whether the assessee loses or wins the suit;
(ii) legal expenses in criminal cases should be allowed only if the person charged is acquitted. If he is convicted, it would mean he has infringed the law—an action incompatible with trading within the law;
(iii) where suit is against the directors of a Company for an offence of control order, etc., if these persons are acquitted of a personal charge and the company under its articles is bound to indemnify them, their legal cost should also be normally allowed.
- (4) Cost of engaging counsel or accountant in fighting out the assessee's case should be allowed irrespective of whether the expenditure relates to appeal or original assessment;
- (5) The arbitrary fixation of what salary a businessman should pay his servant must be left to the discretion of the assessee and all such salary, commission or bonus paid should be allowed. If such salaries are so disallowed, the Government in fairness should not tax the employee on the sum so disallowed, but treat the income in his hand as duly taxed.
- (6) Repairs should be allowed either under Section 10(2)(v) or alternatively under Section 10(2)(xv) if they are wholly laid out for purpose of Company's business. The present amendment in 1953 should be deleted or alternatively the word "current" from Section 10(2)(v) should be omitted.
- (7) Bonus paid to employees is allowed arbitrarily only on basis of three months' salary. Anything in excess, even if *bona fide* and paid purely to retain their services and keep them well-satisfied is always disallowed. This arbitrary rule should go. Unless *bona fides* of payment are challenged or the nature of payment is such as to be suspicious withdrawal of profits by the employer through this device, these should be allowed on the merits.

RATE STRUCTURE.

Question 66

Consolidated Levy.

On a balance of view, it seems that the present rate structure should be retained in spite of some of its shortcomings.

So far as rates are concerned, they are very high. The rates require to be lowered, both in the upper brackets with a view to stimulating savings and consequent formulation of capital and in the lower brackets to give much needed relief to the poor and the middle class people, when there are so many family calls on their income. These calls substantially affect their ability to pay. Especially in the absence of anything by way of family and other allowances as are obtainable in the Western countries, these rates need steepening down.

Question 67

Exemption Limit.

The present minimum exemption limits of Rs. 4,200 for the individual and Rs. 8,400 for the H. U. F. should continue without any change.

DIFFERENTIATION.

Question 68

Earned and Unearned Incomes.

The differentiation between earned income and unearned income seems to be based on the theory that where income needs personal exertion as against income which arises only from passive ownership, the ability to pay must be differentiated. Earned income should be given an abatement or lower rate of tax than unearned income. While for Income-tax distinction is made between earned income and unearned income, no such distinction is made in the higher super-tax groups; possibly on the ground that at that level of income the factor of personal or impersonal exertion does not much count in the production of income.

The present relief given to earned income should be raised to 25 per cent. instead of 20 per cent, and the maximum may be raised from Rs. 4,000 to Rs. 10,000.

MISCELLANEOUS.

Question 69

Valuation of Stocks.

With regard to the principles of valuation of stock, the universally recognised method is cost or market value, whichever is lower. This principle prevails even for Income-tax purposes in most of the European countries. So long as the basis of valuation followed by the assessee is regular and consistent, no objection should be taken for tax purposes.

There is one difficulty in adopting the cost or market value, whichever is lower basis and that is, whether the 'global' method or 'pick and choose' method of valuation of inventory items should be insisted. 'Global' method is where the whole of the inventory list is valued on two basis, one at cost and the other at market value. Whichever list shows in aggregate the value to be less than the other is adopted. The 'pick and choose' method is to compare the cost and market value of each article in the inventory and accept for inventory the lower of the two. The 'global' method is open to the following criticism. It violates the principle of not taking profit into account on any individual article of stock before it is actually sold. Such anticipated profit cannot be made subject of taxation. 'Pick and choose' method adheres to the principle not only in the aggregate, but also item-wise inventory of stock.

Question 70

Hindu Undivided Family Status.

Under the Income-tax Act, Section 25A comes into operation only on the total disruption of the H. U. F. through partial partition is recognised under the Hindu Law and accepted for purpose of Income-tax. It is necessary to make express provision in the Act itself for recognising partial partition. Further where the assessee's status has wrongly been stated in the previous assessment and accepted by the assessee, it should not preclude him by way of an estoppel to claim the true status of an individual if he can satisfy the authorities by means of evidence that the previous status was wrongly ascertained as that of an H. U. F. Proceedings under Section 25A even for a formal declaration of disruption in the above circumstances should not be necessary.

Question 71

Managing Agents.

Surrender of commission by Managing Agents is made in the circumstances when the managed company does not make enough profits or incurs losses, in order to augment and stabilize the finances of the managed company. The question of avoidance of tax does not arise as the Managing Agents themselves do not gain in any way. On the other hand they lose the amount of commission which would be left off after the payment of taxes. In these circumstances, it is absolutely necessary that voluntary surrenders should not be added back to the income of the Managing Agents and taxed in their hands.

Question 72

Double Income-tax Relief.

Double Income-tax relief should be based on the principle incorporated in the avoidance of double tax relief agreement between India and Pakistan. This arrangement in brief is that each country will tax only income which accrues or arises within its own territory at the rate applicable to the world income.

Question 73

Property.

Income from property should be subjected to tax on cash basis and actual outgoing thereout should be allowed instead of *bona fide* annual value less specific deductions. Alternatively, if the present method of fictional computation of rent is to be retained, we would suggest that all municipal taxes including urban immovable property tax should be allowed. Repairs should be allowed on actual basis, provided they are of revenue nature. There must be distinct provision for irrecoverable rents in the Section.

Question 74

Carry Forward of Losses.

The present restriction for the carry forward of losses under Section 24 under the same business should be altered to any business. In case the business is discontinued on the basis of the English Act the losses should be allowed to be carried backward for a period of three years. Whereas under the Amendment Act, if speculation losses are not to be included in total income for rate purposes, there is no logic in including the speculation profits as part of the total income for rate purposes. We suggest that under Sections 24(1) and 16 speculation profits and losses should be treated

under distinct head and not aggregated with the other income.

Question 75

Advance Payment of Tax.

It was a War time measure and as such it has outlived its life. It should, therefore, be abolished. In case it is to be maintained, we suggest as under:—

It is necessary to make a provision under Section 18A to make it mandatory on the Income-tax Officer to re-open an Order when an assessment subsequent to the one on which the Notice is originally based is completed and the subsequent years' profits are less than the profits on which notice was originally based. At present, the third proviso to Section 18A(1) is operated optionally by the Income-tax authorities to the detriment of assessee, in that, fresh notices are issued where the later assessment results in a higher demand, but if the fresh assessment is on a lower income, then the officer does not issue a fresh order accordingly.

Question 76

Principle Underlying Section 34.

Where the Income-tax Officer reopens assessment under Section 34 on the ground that some income has escaped assessment, then he should be entitled to revise the figure of assessment within a period of four years where the assessee has not deliberately avoided the tax; but it is necessary to provide that where as a result of inquiry the Income-tax Officer comes to know that far from there being as under-assessment, there is an obvious over-assessment, then he should be empowered to give relief instead of the present practice of dropping proceedings against the assessee.

Question 77

Assessment Procedure.

The assessment procedure can be simplified by simplifying the tax system in such a way as will enable the ordinary assessee to act by himself.

In order to reduce cost of compliance with the regulations, the Income-tax Officers should always be ready to guide the assessee and should try to give whatever reliefs due to the assessee under the Act even if the assessee has omitted to do so.

There should be no attempt on the part of the Income-tax Officer to reject the result as shown by the books of the assessee unless there are serious defects in the accounts. Sufficient opportunity should be given to the assessee to prove his book result. Mere fall in gross profit by itself should not be the ground for rejection of accounts.

Question 78

Appellate Tribunal.

Sufficient power has been given under the Act for enhancement of assessment right from Income-tax Officer to the Commissioner of Income-tax. The Appellate Tribunal should not be given power of enhancing assessment like the Appellate Assistant Commissioner. If the power is given to Income-tax Appellate Tribunal to enhance the assessment, it will lead to great uncertainty and there will not be any finality of the assessment even after a number of years. If, however, power for enhancement of the assessment is given to the Tribunal, it should be given power to reduce the assessment in similar circumstances where there is over-assessment in their opinion. But such a power to the Tribunal would mean the reassessment of the income, which is not desirable in the interest of justice looking to the judicial nature of the proceedings before the Tribunal.

TAXATION OF COMPANIES.

Question 79

Corporation Tax.

Corporation Tax on Companies, it is said, is levied for the privileges the Company enjoys by reason of its incorporation e.g., juridical existence, limited liability, etc. If that is the reason one fails to see the propriety of its being regarded as additional tax on income. Logically such Corporation tax should be allowed as a deduction instead of it, like Income-tax, being treated merely as an appropriation of taxed profits. If on the other hand, it is really an additional Income-tax levied by the Government on its income, there is no logic in withholding credit to the shareholders on the distributed profits, like the Income-tax. This is an anomaly which affords the Government the best of both the worlds and leaves the poor tax-payer the worst of a bad deal.

Element of progression could be on the supposition that the Corporation tax is really an additional levy of tax on income and not on its corporate existence. Introduction of progressive element could only be justified on this hypothesis. If, however, Corporation tax is a tax on its corporate existence progressive levy is not warranted

Questions 80 and 81

Differential Rates.

Differential rates according to the different types of corporate enterprises will introduce complication in the already complicated tax system. The present flat rate Corporation tax should be continued. Proprietary concerns should not be differentiated for assessment, if it is an incorporated entity duly registered under the Companies Act. The restrictions imposed under Section 23A of compulsory distribution of profit should suffice. About holding companies the question that looms large is the double payment of Corporation tax once by the subsidiary company on its own profits and again by the holding company on its dividend income from such subsidiaries. The claim for exemption of intercorporate dividend is justified on the ground that there should be only one tax levied on the income while it passes from the company to its individual shareholders. The holding company merely holds investments of its various subsidiaries; Corporation tax on such passive flow of income, pending its ultimate distribution, is not justified.

Question 83

Distributed and Undistributed Profits.

The present differentiation between distributed and undistributed profits should be abolished. It has created complication, thrown additional work on the staff, resulted into delays, etc. Tax on the profits of the Company should alone be imposed, without the refinement of an abatement on undistributed profits or an additional tax on distributed ones. Since it is advocated that this differentiation should be abolished, the question of restricting it to particular industries does not arise.

If, however, the present differentiation is to prevail, the provision with regard to additional tax on excess dividends should be retained but the outer limit should not exceed the maximum rate of tax on a company.

If it is to be ensured that retained profits are applied only for productive purpose, the rehabilitation reserves so created should be ear-marked.

Operation of Section 23A.

A feature of this section which requires review is the action taken by the Income-tax Officer under Section 23A. It is not taken simultaneously with the assessment of the Company. It is taken much later even after years. This places the shareholders and the company in a very awkward predicament having to pay tax on an adjustment of this artificial income although the company has declared no dividend. And further the company itself may find it difficult to meet the shareholders' liability as provided in the Section on account of accumulated subsequent years' losses. It should be especially provided that the proceedings under Section 23A must be completed along with the assessment.

If upon the assessment it is found that on account of add-backs the Company's distributable profit has increased and, therefore, the previous distribution is found deficient, the Income-tax Officer should be empowered to give opportunity to the company of a further declaration so as to make up the said 60 per cent. requirement.

There is also some doubt existing as to the true meaning of the phrase 'unconditionally allotted to'. This should be clarified to mean such conditions as fetter the right of the shareholder to vote in a particular way and not any condition as to compulsory deposit of funds, etc. as are provided in the Articles of the Company. In case of a private company, being a shareholder of such a company, unless such company consists of the persons who control the company in question, it should be allowed to be treated as a member of the public notwithstanding the fact that such share-holding company itself may or may not be liable under the provisions of Section 23A of the Act.

Question 84

Corporation tax and Share-holders Super-tax.

Profits subject to Corporation Tax should be subjected to Super-tax only after credit is given to the shareholder on account of not only Income-tax but also Corporation tax paid by the Company. This is on the ground that Corporation tax is an additional Income-tax and should receive the same treatment in the hands of the shareholders.

Question 85

Industrial Enterprises.

Industrial Enterprises undertaken by the Government or local bodies should not be subjected to tax, for they do not exist for individual benefit but for the nation. If, however, their enterprises compete with the individual business i.e., if they do not enjoy a monopoly in them, same basis of tax on their earnings would be justified in order not to give them an unfair advantage in market competition of their products or services.

EVASION AND AVOIDANCE OF TAX.

Question 86

Services of Chartered Accountants.

Assessee should be free to decide whether or not to avail themselves of the services of a Chartered Accountant for assisting in the determination of their taxable income. The employment of a Chartered Accountant should be on the basis of agreement between him and his client, and the Department should not seek to enlarge the functions for which the client has employed a Chartered Accountant. We do not agree that the certificate of a Chartered Accountant is invariably necessary in the case of a return of business income over a certain limit nor do we agree that a form of certificate should be prescribed, indicating the scope of check that should be exercised by a Chartered Accountant. The fees payable to a Chartered Accountant should be the matter of arrangement between him and his client and should not be restricted to a Schedule to be prescribed by the Government. When an assessee selects a Chartered Accountant, he makes a choice of his own free will as to the best person in his opinion to handle his work. Therefore, the fees to be charged, as in the case of an attorney, should be left to the settled between the client and the Chartered Accountant.

Question 87

Representation.

There are amongst the unqualified experts who are really good and honest but their number is small. It is to the interest of the department to gradually do away with non-qualified experts. Only Chartered Accountants and Lawyers should be allowed to practise. The rule should be made more and more rigid to shut out undesirable elements.

Question 88

Disclosure of Names.

There are penalties prescribed under the Act for concealment of income which are more than sufficient for a check on evasion of tax. There is thus no need of publishing the names of persons who are penalised for concealment of income.

Question 89

Perquisite.

It is difficult to say what loss of revenue the Government suffers by permitting the exclusion of perquisites from taxable profits. *Prima facie* it is not thought to be considerable. Unless it develops into a scale which endangers public revenue, the present practice should continue.

Question 90

Tax Due by Company in Liquidation.

A Company in liquidation should safeguard its funds to the extent of taxes levied by making it a first charge on the assets of the company and making the liquidator responsible for it unless after due notice and enquiry he distributes the funds in his hands. It should be duty of the Department to complete the proceedings after through enquiry so that nothing is left to be done after the liquidation proceedings are over.

Question 91

Power of Income-tax Authorities.

Larger powers in the hands of present personnel are likely to result in more harassment, greater corruption and smaller revenue. Care should also be taken to see that authorities do not act upon an anonymous report written by a rival in trade, enemy, disgruntled employee or a blackmailer. If action is taken on the report of such a person the Department must be in duty bound to disclose the name of the informant for a suitable action by the assessee, if the report is proved to be false, baseless and actuated merely by the malice and the motive to blackmail and harass.

Question 92

Creation of Legal Entities.

The present practice of converting private property into trusts or private limited companies with a view to mitigating heavy tax incidence, is not so widely spread as to merit legislation against it. The legitimate way of lessening one's tax burden by formation of companies, partnership, trust, etc., should not be disturbed.

RECOVERY.

Question 93

Tax Due by a Partner.

In case of registered firm, firm is an assessee but tax is recovered from partners. If any tax is unrealised, provision for recovery of such tax may really conflict with the principle of individual assessment. Why should partners' unrealised tax be borne by the firm when the assessment proceeds on the principle of individual responsibility? But if any such provision is made it must be clearly provided that only such part of personal

tax may be recovered from the firm or other partners as relate to his share in the partnership business only.

Question 94

Machinery of Recovery.

Where the Department itself was lethargic in making assessments which are delayed for a number of years for no fault of the assessee sufficient time should be given to the assessee for payment of tax for more than one year in one financial year. No penalties for delay in payment of taxes in aforesaid circumstances should be levied. The arrangement for recovery of tax is quite adequate. What is required is vigilance and efficiency on the part of the Department for the recovery of tax. There is an adequate machinery prescribed under the Act for enforcing recovery of tax from the resident assessee. It is only in case of a non-resident or a foreign assessee that some special machinery for enforcing payment of tax is called for and especially in case of a foreign company under liquidation to avoid heavy loss to the revenue. Similar special machinery may be prescribed for other resident persons who are likely to leave India for the purpose of settling down abroad with no intention to return to India.

Question 95

Private Companies.

Private Companies tax should be met out of the assets of the company and not from the shareholders. When the assessment proceeds on the assumption that company pays its own tax as an entity on behalf of the shareholders, how does it become logical to say that company's unrealised tax shall be recovered from the shareholders? A principle should not be tinkered with. It is not proper to say that for purposes of assessment, the Company's legal entity will be recognised, for levy of income-tax at maximum rate and Super-tax, yet when this tax is unrealised the legal entity ceases to operate and there is a sudden change in the principle and it is said that company is but an alias of the shareholders composing it and, therefore, the tax is recovered from the shareholders. A company for purpose of assessment is deemed to be a company but when recovery proceedings start, it suddenly becomes a partnership, each partner becoming liable to pay not what he receives, but what the company earns, whether it is distributed or not. Such liberties with the principle to suit the exigencies of recovery are bound to make a hash of a principle and hold it up to ridicule.

Question 96

Property Income.

Here also there does not seem to be any logic. Why should income of one be treated as income of the other. If it is on the ground that the income though legally transferred to another, really belongs to the transferer, the person who is taxed should be responsible for the tax; why should another man bear a liability to pay the tax of another when legal liability is not his? If the transfer is not real but a camouflage, then law is strong enough to pursue its remedies against the so-called transferee as a *benamidar* of the real owner.

GENERAL.

Question 97

Relations.

The greatest need of the tax-payer and the Department is to find ways and means to make the Department more reasonable in its demands for tax and the tax-payer to be honest and straightforward. Each must realise that on the improved tone of relationship between the tax-payer and the tax-gatherer, depends the smoothness of the working of the tax machinery, recovery of revenue and general satisfaction that not only proper taxes are collected but they are willingly paid as a mark of good citizenship. This can only be done when laws made are neither harsh nor inequitable and oppressive. And the citizens learn the duty of paying proper taxes willingly without resort to the expediency of manipulation and fraud. Tax-payers must be made to realise that tax wrongly avoided must reach on the community as a whole by higher taxes and harsher laws. It does not pay to avoid paying one's true taxes. But to achieve this the Department must be scrupulously fair—their anxiety must not be to collect tax anyhow—as some one bluntly put it by hook or by crook. In this matter one should recall the maxim that it is not sufficient to do justice, but make the tax-paying public feel that justice is done. They must not be suspected: their statements should not be open to challenge unless some evidence justifies such inference. Assumptions and presumptions must give way to proofs and evidence. The Income-tax Officers must see that an assessee is not harassed by rejecting books on flimsy grounds—adopting unconscionable Gross Profit and requiring immediate payment of taxes irrespective of the state of his finance. His assessments must not be delayed, prolonged scrutiny year by year being made although nothing is detected or found; refunds should be paid as promptly as tax demands recovered. Appeals should be heard and disposed of judicially and not in

atmosphere where everything Income-tax Officer says is believed, everything the assessee says is rejected. The consummation of good and improved relationship in an office of liaison officer is a crying need. This officer should be scrupulously fair and beyond the reach of temptations, efficient, sympathetic and judicious by temperament. He should be able to control the vagaries of some officers and offer tax-payers of lower brackets advice as to filling in of returns, maintaining of simple accounts, claiming refunds and help in expeditious disposal of his old assessments. He should give free advice to the small assessee on the subject and also that their genuine grievances are immediately redressed into and redressed by proper approach.

It must be upto this Officer to see that tax-payers do not come and complain against authorities are not harassed by them.

Any inquiry either oral or written from an assessee on various matters relating to assessment proceedings, such as disposal of refund applications, adjournment of applications, examination of records, etc. should be promptly dealt with by the Income-tax Officer concerned. On no excuse should there be delay of more than a month for merely replying to such inquiries. Cases have come to light where the applications for cancellation of apparent mistakes under Section 35 have remained unattended to for more than a year and penalty has been levied on the assessee for non-payment of tax even before the order under Section 35 is made by the Income-tax Officer.

The agreed facts between the assessee and the Income-tax Officer should be recorded by the Income-tax Officer and a copy thereof should be supplied to the assessee to avoid dispute at a later stage.

Section 98

Assessment and Appellate Procedure.

With regard to issue of Notices and simplification of filling of returns, the present practice requires no change, except that Notice for asking for information completing assessment within a few days before the return, the same becomes barred should be discouraged. If taxes are imposed for the current year as well as for past years together, reasonable time should be given to the assessee for payment.

Issue of notice should be always on the assessee and not on any other person except where a special authority is given by the assessee to some other person to be recorded by the Income-tax Officer.

The form of return should not be very elaborate and complicated but simple and intelligible. The present simplified forms of return are in some respect better than old ones.

Penalties levied now for technical offence should be discouraged. The Act itself is so complicated that even experts are baffled by its obscurities. Penalties should be by way of deterrent, not with a view to collecting revenue. Any such motive to collect revenue violates the principle of deterrence and punishment. Every set of tax provisions are comprehensive enough and need no further tightening up.

Under-estimate for advance payment of tax in case of business with wide fluctuations of profits should not be the ground for penalty unless it is definitely proved that the assessee has deliberately furnished inaccurate particulars of his income.

Omission on the part of the assessee to add back any apparent disallowables by themselves should not be the ground for invoking the penal section unless the assessee has deliberately omitted to defraud the revenue.

Rejection of accounts on the ground of lower margin profit and addition to the actual income disclosed by books should not attract penalty for concealment of income unless the Department can definitely lay their hands on some serious omissions or defects in the accounts.

Penalty should not be imposed in cases of cash transactions in the accounts of the partners, proprietors or other persons which the Department merely suspects as secret profits without any evidence in its possession. The onus of proving that such cash credits are secret must lie on the Department before a penalty can be levied.

Where a refund is due to the assessee from the other Income-tax Officer e.g., for Excess Profits Tax Deposit, Excess Profits Tax refund, Business Profits Tax refund, he should not be called upon to pay the demand for the refund due to him from the other Income-tax Officer. The refund due to him should be adjusted against demand made against him and only net demand should be enforced. Where the assessments are demanded for no fault of the assessee, demand made for more than one assessment year in one financial year should not be enforced without giving sufficient time to the assessee unless the Department has in its possession information that the assessee is likely to dispose of assets and or is likely to leave India for settlement abroad.

The practice of Income-tax Officer calling assessee on particular dates and at particular time and making them wait outside for long hours could be easily avoided by the Income-tax Officer disposing of his work expeditiously. Nothing could be easier for the Income-tax Officer to give a fresh date when the proceeding case has taken unexpectedly long time.

The work of assessment should also be prompt and not delayed by meticulous inquiries and information which lead to no result except time consuming delays. There are cases in which for years there is not much difference between income returned and income assessed. In such cases liberal use of Section 23(1) is called for. Further such assessment should be reviewed every three to four years to mark wide fluctuations in incomes and expenses from the usual. Small assessee should not be harassed on account of imperfect book-keeping. Accounts should not summarily be rejected. He is likely to feel the extra incidence the hardest. Much revenue is not likely to be lost if meticulous scrutiny is not resorted to, except in cases of definite information in the possession of the Income-tax Officer.

Appellate procedure needs a change. The Appellate Assistant Commissioners should not be placed under the Commissioner of Income-tax. No amount of assurance to the effect that they are free to act judicially without fear or favour will satisfy the public when their pay, promotion and transfer are vested in the hands of an executive officer like the Commissioner of Income-tax. The ever hanging sword of being in the bad books of the Commissioner of Income-tax and constant disagreement with the inspecting Assistant Commissioner with regard to his decision makes him hesitant to give relief to the tax-payer, lest the Department might go to the Tribunal in appeal against his order. The Appellate Assistant Commissioners should also have no power to enhance assessment. That is an executive function incompatible with the judicial post he holds.

Question 99

Delay in Assessment.

Undue and inordinate delays in Income-tax Proceedings have become almost chronic-proof, vide the number of arrears in the Department. In order to expedite assessment and avoid undue delays—

- (1) meticulous scrutiny of accounts every year should not be necessary where the previous records show a clean assessment;
- (2) refunds should be expeditiously disposed of, within, say, three or four months of application for refunds under Section 48. Similar prompt relief should be granted under the Appellate Assistant Commissioner's Orders or Tribunal Judgements;
- (3) remand reports should be promptly attended to and made within the time given by the Appellate Assistant Commissioner;
- (4) technical errors should not be magnified into serious omission and penalty levied for the default, necessitating long appeal procedure;
- (5) taxes should be collected giving assessee facilities of instalments or postponement according as the tax, imposed is large and major portion of which is in dispute and in appeal;
- (6) feeling should be generated amongst the tax-paying public that honest assessee need not be afraid of receiving prompt and courteous treatment but expeditious disposal; that the Department is considerate and sympathetic of the difficulties facing trader in regard to finances and trade slump;
- (7) the quarterly advance payment must now be discontinued, and the old method of collecting tax on assessment should be resorted.

There is a tendency at present among the Income-tax Officer to take up some assessments only in the last month of the year lest they may get time barred in the next year. This creates a lot of difficulties and embarrassment to the assessee in complying with the various requisitions of the Income-tax Officer within a short time. The assessee is thus required to preserve his old records for more than five years in some cases. On the slightest excuse of not furnishing a particular book or record, there is a tendency on the part of some of the officers to proceed with the assessment hurriedly without sometimes giving proper thought or consideration to the submission made by the assessee. In order to put a stop or check on such practice of the Income-tax Officers, there should be proper review of such cases by the higher authorities. The Income-tax Officer should in all cases be warned by the higher authorities to take up the assessments within a reasonable time from the date of submission of the return. Otherwise there is a likelihood of loss of heavy revenue to the Government and unnecessary hardships and troubles to the honest tax-payers.

Cases of assessee declaring losses or claiming refund should not be given a differential treatment by the Income-tax Officers. They should also receive the same

attention and treatment as the other assessees. Their assessments should not be delayed unduly for a long time.

Cases already taken up where information is collected for purposes of assessment, should not be left over by an Income-tax Officer where he knows that he is under transfer and the transfer is not made in the mofussil. In such circumstances transfers may be delayed for a short period to avoid unnecessary expenses, troubles and worry to the assessee in producing again all the books of accounts and documents already produced before his predecessor.

Question 100

Special Business Taxes.

The Excess Profits Tax and the Business Profit Tax were brought into existence to meet the exigencies of making large fortune due to the emergency of war. These conditions having past these special taxes should not figure in our Statute Book. Taxes of abnormal nature should be reserved for abnormal conditions.

DEATH DUTIES.

Question 101

Estate Duty Bill.

The Estate Duty Act has been brought into force at a time when there is acute depression in industry and trade and consequent acute unemployment in the country. It will retard progress of development of existing industry and trade and give set-back to its expansion. It may thus indirectly increase unemployment in the country. The levy will kill incentive of the individual industrialist and businessman for future progress.

Question 102

Self-Acquired and Inherited Property.

Distinction between self-acquired property and inherited property of the deceased is desirable, so that differentiated rates may be applied to these. Self-acquired property rates should be lower than those for property which is inherited by the deceased.

PART III.—COMMODITY TAXES (Central and States)

CUSTOMS.

Import Duties.

Question 103.

There is no doubt a need for revising the Customs Tariff Schedule. This problem arises primarily due to the serious divergence between the Customs Tariff Schedule and the present Import Trade Control Schedule. The latter, as it stands today, contains 601 items each of which is given a serial number and has further sub-divisions. Whereas in the case of the former, there are only 87 items. The pattern of our foreign trade has undergone a significant change since import tariff was framed and therefore this schedule needs drastic revision. It should also be kept up to date to meet changing pattern of trade.

Considerable inconvenience is caused to importers due to the lack of co-ordination between the Customs Schedule and Import Control Schedule. Instances have not been wanting when importers having procured the license for import of the particular set of goods, have been told that the goods are differently classified by the Customs authorities. The result has been the payment of heavy penalties, or pending settlement, mounting demurrage charges.

It is understood that the Government is keeping in consideration an early revision of the Import Trade Control Schedule. We, therefore, suggest that this opportunity should be taken to revise the Customs Tariff Schedule also on the same lines, in order that uniformity is maintained in respect of descriptions of articles in both the Schedules. It is needless to mention that unit of weights and measures adopted should conform to the international standards.

Question 104

- (i) The twin considerations that govern the levy of an import duty are revenue yield and protection to the industry in question. The two are not always complementary. Often revenue needs might render it inadvisable on the strength of the import demand to levy a duty high enough to protect the concerned industry. In such cases, preference should be given to protection consideration if the industry is of national importance. After all, import duties are but one of the many sources of public revenue. It would be appropriate if the rates are fixed in consultation with the Tariff Commission. We are, however, opposed to additional import restrictions being placed by the Government on import of certain articles over and above

the import duties for granting additional protection to some industries by banning restricting import quotas.

- (ii) We are definitely of the view that there is urgent need to modify the present rates duties in respect of the import of raw cotton.

Further the case of textile machinery deserves social consideration. The existing machinery is considerably worn out during the V and its rehabilitation is an urgent necessity. It is equally important for the Industry to modernise the plants to meet the international competition. This will show how the industry requires machinery worth crores of rupees for replacement and renewal purposes. The present rate of duty is 5½ per cent. *ad valorem*. This rate is very heavy considering the present inflated prices of machinery. In order to accord some relief to the textile industry it is imperative to substantially reduce the present rate and we would suggest that same should be brought down, if not completely withdrawn.

Under item No. 72 (34) of First Schedule Import Tariff, there are specified items of Textile Machinery, viz., Spinning Ring Frames, Spinning Rings, Spindles and Plain Looms, which are also indigenously manufactured are subject to a protective duty 10½ per cent. *ad valorem*. The import of these items is very restricted and only a small number permitted for import in deserving cases special considerations. We would suggest therefore, that in view of heavy restriction on import of these items, it is not necessary to impose protective duty which would increase the cost unnecessarily.

- (iii) The practice of smuggling has very little to do with the levy of import duties. Smuggling is the outcome of import control, the only way of eliminating this is to make the import control machinery more effective and penalties heavier.

- (iv) There are a number of cases where duties on the constituent parts are higher than on the finished products. For example, while the duty on motor cars is 75 per cent. on the auto-parts the duty is 94½ per cent. Similar is the case in other types of machinery and spare-parts. The argument for levying higher duty on spare parts is that the spare parts have a larger range of use than assembled machine which has only a specific purpose. This argument may be generally true but in the interests of effective replacements and renewals of industrial equipment it is essential that this disparity should be revised. A system of drawbacks may be instituted with regard to the import of spare parts for genuine purposes of replacement.

- (v) It is quite possible that high rates of duty in respect of certain commodities, such as few luxuries may have so much reduced the volume of imports as to result in diminishing tax returns. But, as long as there is a system of import control, it is difficult to assess whether a point of diminishing returns has been or not.

Question 106

'Tariff Values' are deemed to be a satisfactory basis for assessment of duties in those cases where there are seasonal fluctuations in import prices for example, currents, dry fruits, etc. In such cases annual average of the previous months is taken as the guiding 'Tariff Value'. This seems to be a reasonable method, and therefore, no changes are needed in this direction. Not many major commodities are subject to this difficulty. It is a matter of administrative discretion to widen the list of commodities to which 'Tariff Values' should be applied or not.

Question 108

All of the materials mentioned in (i), as well as capital equipment for industry should be exempted from import duties or at least, the duties must be a minimum.

In particular we would like to emphasise the view to withdraw the duty on the import of raw cotton which is a basic raw material for one of the most essential industries, which also accounts for a sizable portion of urban industrial employment.

Imported Cotton is subjected to a duty of 2 annas and 1-1/5 pices per lb. Though this duty has been in existence for a long time, the burden on this account increased enormously with partition. India has now to import a very much larger quantity of cotton than pre-partition days, when cotton grown in areas now under Pakistan, was available to us as home produced cotton. At the present volume of production, it

annual cotton consumption amounts to more than 40 lakhs bales. Home supply of spinning cotton is about lakhs bales. This means an import of not less than lakhs annually and the import duty on this quantity amounts to about 4.2 crores. The rates of Excise Duty on Fine and Superfine varieties of cloth which are solely manufactured from imported cotton is already very high. The additional burden on the Cotton Textile Industry on account of Import Duty on cotton is, therefore, obvious and hence the consumers have ultimately to bear a heavy burden. There is no justification for such a levy. This argument gains additional strength when one realises that no import duty on cotton is levied either in U.K. or U.S.A. or Japan. In the interests of lower costs, higher efficiency and larger employment, this duty calls for an effective reduction, if not, complete withdrawal.

Question 110

In a free economy, preference should certainly be given to customs duties in preference to import quotas as means of restricting imports. For one should not abolish free choice and if the importer, in spite of a heavy duty desired to import, he should be allowed to do so. But in the present abnormal balance of payment difficulties, import quotas have to be resorted to in order to conserve foreign exchange if the other methods do not succeed. As long as exchange control is necessary, restriction on imports by regulating import duties may be effective.

Question 112

There is at the moment no statutory provision for settlement of disputes involving appraisal, nor is there any right for appeal from an order of the Chief Customs Authority. This is not fair to the importer and is not in accordance with the principles laid down under GATT to which India is a party. Article X of GATT requires the setting up of tribunals for the prompt review and correction of administrative action. We strongly feel that such tribunals should be set up in this country.

Export Duties.

Question 113

In the case of cotton textile industry, we strongly feel that there should be a complete withdrawal of the export duty. This duty was levied when we had a seller's market and enjoyed tangible price differentials. We have long passed that stage and we are now facing a buyer's market abroad with terrific competition from other countries of the World, particularly Japan. If duties were to continue to be a major exchange earner, and if home production and employment should not suffer, it is imperative that the export duty on cotton manufactures should be abolished.

Question 115

It is always desirable to have a consolidated system of finance in which all the individual projects are properly integrated and priorities drawn. Therefore, we do not suggest that receipts from export duties should be earmarked for specific long range schemes of promoting export trade. In fact we are of the opinion that the industry concerned can take care of the development of export trade if the duties are withdrawn and the advantages of the price differential are given away entirely to the industry.

Question 116

We are opposed to any further extension of State trading. In fact the function of the Government should be merely to intervene with a view to maintaining an overall balance in our foreign trade and balance of payments. This might call for certain types of intervention only when necessary. For example, exchange control and quantitative controls may be necessary to conserve foreign exchange and relieve internal shortages. But apart from this there is no need for the State to participate in foreign trade, except in times of grave emergencies.

CENTRAL EXCISE.

Questions 117 and 118

It is but natural to levy excise duties on articles of consumption as one of the indirect taxes in a country where the scope for direct taxation is restricted and a large part of the revenue has to come from indirect taxation. In fact there is a very strong case for the imposition of Salt Duty in India because even a thin layer of taxation on this commodity will yield large returns without imposing heavy incidence on the consumer. But we are definitely opposed to a policy of levying Excise Duties on industries which are already suffering under the burden of other types of taxation and which are vital industries whose development is in the wider interests of employment and economic welfare of the nation. The Cotton Textile Industry is a typical instance of this category.

Nor do we always approve of the practice to levy a counterpart Excise Duty on internal manufactures

whenever imports are prohibitive or heavy duties are imposed on imports.

The Cotton Textile Industry is easily the most heavily taxed industry and a good part of this burden is due to the imposition of high Excise Duty, which on Fine and Superfine cloth amounts to 1½ annas and 2 annas per yard respectively. The Government estimated in their Budget for the year 1952-53 a revenue of rupees seventeen crores from this source. With the imposition of the additional duty of a quarter anna per yard on all mill made cloth to protect the hand-loom weaver, the Government is in a position to collect an additional sum of about 5¼ crores of rupees.

It has been estimated by the Bombay Millowners' Association that since 1948, a colossal sum of over Rs. 50 crores represents the additional cost to the industry.

In the present context of recession and growing unemployment, any continuation of the existing rates of excise would hard hit the industry. The market of the industry has changed into a buyer's market and there is consumer resistance even at reasonably low prices.

It is feared that textile prices may be beaten down further by the market conditions in which case all the burden of the excise duty and import duty on cotton have to be borne by the manufacturers. This would result in heavy losses and part or full closure of mills involving further unemployment and loss of income to the country. The only measures which could be adopted to lower the cloth prices is to reduce the labour cost and abolish the Excise Duty. In the present circumstances it is not possible to reduce labour cost. In the light of these facts, we strongly recommend the complete withdrawal of Excise and Export Duty on cloth as well as Import Duty on raw cotton or drastic reduction in the same.

Question 121

There is considerable scope for reducing the administrative expenditure on this account by simplifying the system of control. The duty being now uniformly levied on specific rates on all varieties of cloth, in our opinion, it is not necessary to increase heavy expenses on part of Government by posting large Excise Staff in each mill. In past when Excise Duty was levied, it was collected on basis of production and a very small staff was employed for collection. The same method should also now be adopted.

Question 122

We do not think it necessary to earmark any part of the proceeds of Excise Duties for expenditure on research and development Schemes designed to improve the quality and marketability of the commodities. As indicated in our answer to Question 115 we do not favour this linking of specific sources of revenue with specific items of expenditure. Since our Government has launched a Five Year Plan, it is appropriate to have a consolidated system of revenue and integrated public expenditure.

Question 123

We have already brought about in the course of our answer to question 117 that the imposition of Excise Duties has affected adversely the development of the Cotton Textile Industry both with regard to its size and its competitive capacity.

Salt Duty.

Question 124

We recommend the reimposition of Excise Duty on Salt. This is one of a fruitful sources of revenue yielding large returns even at a low rate of taxation. The rate of Excise Duty should be uniform all over the country.

Question 126

It is not desirable to levy a tax on sales of newspapers because the sales tax would be fractional and cannot be passed on to the buyer, whereas in the aggregate it would be an undue burden on the concern itself.

But there is certainly scope to levy a tax at a reasonable rate on advertisements with certain exemptions.

Question 127

It is theoretically simple to point out that after all sales taxes belong to one of the three categories, viz.—

- (1) Excise,
- (2) Octroi and Terminal Taxes, and
- (3) Customs.

But the field covered by sales taxation is very much wider than what can possibly be covered by any or all of these three categories. We are of opinion that Sales Tax has a specific function to perform in the country's system of taxation.

Question 128

- (a) Yes. We agree that in Indian conditions that the bulk of Sales Tax should continue to be

leviable on aggregate turn-over as distinguished from the individual sale price.

- (b) We do not favour extension of the system. On the other hand we suggest that all such articles should also be brought under general Sales Tax Law.

Question 129

- (1) On careful consideration of the problem we are of the definite opinion that Multi-point Sales Tax is not suitable to an industrially advanced state like Bombay. On the contrary, we strongly favour levying of tax at only one point, viz., the point at which a registered dealer sells either to a consumer or to an unregistered dealer. The transaction between registered dealers should be exempted from such tax. Further a dealer below a certain limit of turn-over should be excluded from compulsory registration. Lastly all the essential commodities and industrial raw material and capital goods purchased by industrial establishment for the purpose of manufacture should be exempted from the levy. It may be added here that the recent experience in Bombay State has proved that the Multi-point Sales Tax was to a certain extent responsible for the crisis in the Textile Industry and that the single point tax is easier to administer and also more comprehensible to the business community in general.

- (2) (b) and (c). Under the Single-point Sales Tax, large number of dealers whose sales would be to registered dealers will be spared the trouble of assessment. Only the dealers at last stage, viz., retailers will have to show their accounts for the purpose of assessment. This would considerably lighten the work of the Assessing Authorities.

The raw materials and capital goods purchased by the Industry will be exempted from the levy as they would be purchased from registered dealers and as such no burden by way of Sales Tax will be imposed on the Industry and their competitive capacity *vis-à-vis* similar industries in other States would remain unaffected.

- (3) (i) In our opinion, Single-point Sales Tax will not lead to a greater burden being placed on the consumer than is accounted for by the proceeds which accrue to the exchequer as there would be fewer opportunities for misappropriation under the Single-point System than any other.
- (ii) With a view to make the administration of the tax less burden some to the dealer, it is imperative to simplify the forms and accounts. The assessment work should also be expedited and completed within a prescribed period after the returns are submitted by the assessee.
- (iii) According to our information, the Multi-point Sales Tax has resulted in eliminating the intermediaries and has thus adversely affected the normal trade channels.
- (iv) We are of the opinion that the system of licensing of dealers which was in force in Bombay under the Single-point Sales Tax could minimise the chances of evasion.

Question 130

- (1) There should be no objection for rates of levy on luxury and semi-luxury items such as motor cars, frigidaires, radios, etc., to be higher than the ordinary rate.
- (2) There should be definitely lower levy, lower than the ordinary rate in respect of articles consumed by middle classes. Taxes on commodities which constitute an important item in the cost of living should be kept low in the wider interests of production and employment.
- (3) In order to avoid double taxation and consequent addition in cost of production, raw materials and capital goods purchased by industrial establishments should be exempted from the levy of Sales Tax. Further all the essential goods (*vide* the Schedule of articles given under the Essential Goods (Declaration and Regulation of Tax on Sales or Purchase Act, 1952) should also be exempted from the tax.

Question 131

In our opinion it would be in the interest of a unified economic policy of the country that there should be a constitutional amendment so as to include the item of Sales Tax as a whole in the Union list. In this case the centre will collect the proceeds and distri-

bute among the States in a rational manner. Of course the basis for allocation would be the amount of revenue that accrue from each State.

Question 132

According to our information there is at present uniformity with regard to exemptions in favour of goods essential for the life of the community under Clause (3) of Article 286 of the Constitution. The guiding principle for deciding the exemptions under provisions of the article should be (1) whether it is article required by the citizen to maintain himself; (2) is it a raw material consumed by indigenous industry. In practice, however, the Central Act become inoperative in certain cases. The State of Bombay which had already levied a tax on Cotton for example is allowed to continue this practice while the article insists on the exemption clause with respect to other States. This is a serious anomaly. The exemption list should be standardised for all states and should be given retrospective effect.

Question 133

If the Centre takes over the collection of sales taxation, the existing difficulty caused by exemption from taxation of goods exported from one State to the other and other inter-state problems can be conveniently solved. Moreover, the distinction between Purchase Tax and Sales Tax ceases to have any validity.

In the alternative we are of the opinion that residence of the dealer should be made the criteria for levy of Sales Tax. If the jurisdiction of States is so restricted the trade and industry would definitely know what is their exact liability.

Question 134

In our opinion, the lack of uniformity between States as regards the rates of Sales Tax and methods of applying it (single or multi-point) does have the effect of raising barriers in inter-state commerce and of inducing uneconomic divisions of trade. If there is centralisation of Sales Tax as suggested by us earlier the difficulties would be obviated.

GENERAL.

Question 136

In our opinion, power to alter the rates of import duties, export duties and excise duties should not be vested in the administration.

PART IV.—AGRICULTURAL INCOME-TAX, LAND REVENUE AND IRRIGATION RATES.

Questions 139 to 142

We have already indicated in an earlier part that equal incomes should be equally taxed irrespective of source of earnings or residence. As such we favour collection of revenue from agricultural sector by way of taxing Agricultural Income.

Question 149

No modifications are necessary with regard to land revenue settlement in the case of co-operative farms. The only point to note is that there will be great convenience in collection and economy in administrative costs. The benefit of such economies may be passed on to the co-operative institutions by way of concessions as an incentive.

Question 151

We are of the opinion that the present principles properly applied are satisfactory.

IRRIGATION RATES AND BETTERMENT LEVY.

Question 155

Where a major irrigation work has been constructed by the state, the taxes to be recommended are (i), (ii) and (iii) that is—

- (i) a betterment levy representing a portion of the increase in the value of land,
- (ii) an irrigation rates for the water actually supplied, and
- (iii) a small cess.

No other tax is suggested.

Question 156

This is a question which depends on a number of considerations like the extent of betterment effect, the time period over which the entire levy has to be distributed, the present capacity of the land owners to pay, etc. No clear cut formula can be given in this regard. We advocate the collection of betterment levy only after the realisation of a substantial increment in the value of land.

With regard to lands already benefited by an existing irrigation work, whether to impose a betterment levy or not depends on the prevailing rates. If the

rates are already adjusted to this factor, there cannot be any scope for additional levy.

The proceeds of the levy should always be to reimburse only those accounts connected with the specific purpose for which the levy is made.

Question 157

- (i) In principle the irrigation rates should just cover the cost of providing the supply of water and no more.
- (ii) The rates should be based only on—
 - (a) Area irrigated, and
 - (b) quantity of water supplied.
- (iii) There should be flexibility in the fixation of water rates. The actual duration of the period over which a rate is effective is a matter of administrative convenience.
- (iv) Concessional or incentive rates particularly in the initial stages of development are definitely desirable.

Question 158

The compulsory irrigation cess should just cover the total annual cost of maintenance of such local works.

Question 159

The principles are the same, but the levy should be relative to the benefits conferred by such work.

Question 160

Consolidated rates are not in the interests of the rate-payer. The rate payer should know all details about what for he pays and how much for each.

Question 161

For financing projects of a local character, there should be no imposition of a surcharge on irrigation rates based on crop values, sizes of holdings, etc.

PART V.—OTHER TAXES (Central and States).

STAMP DUTIES AND COURT FEES.

Question 162

The existing rates of duty on commercial documents are pretty high. It may be recalled that duty payable on cheques was withdrawn in 1927 in order to promote the development of banking in this country and this was a right step. Particularly under the present context of the Five Year Plan it is extremely important to encourage the banking habit and canalise the cash balances into productive activities. Therefore, there should be no re-imposition of any duty on cheque payments. On the other hand, in our opinion, there is a case for reduction of duties on Bonds and Bills of Exchange.

We suggest that there should be uniformity throughout the Indian Union with regard to the taxation of stamp duties.

Question 163

On principle we see no reason why there should be a duty on forward contracts. Any such duty is bound to act as a restraint to free trading in future and restricts the volume of turnover. No one can deny the importance of futures trading as a stabiliser of a free economy and, therefore, we feel that taxation of forward contracts which is responsible to some extent for restricting the turn over is undesirable.

Question 164

It is highly doubtful whether to substitute a stamp duty for the tax on sale of goods in its present form is practicable at all. It is very likely that this might result in evasion. Moreover, from the view-point of economy in tax collection, taxes would be preferable to stamp duty, since collection on the basis of turnover is easier.

Questions 166 and 167

The uniformity in the rates of Court Fees throughout the Indian Union is definitely desirable and administratively feasible.

TAXES ON MOTOR AND OTHER VEHICLE.

Question 168

A vehicle tax is clearly a tax on transport and therefore, adds up to other forms of indirect taxes. Transport cost is an important constituent of the cost of production of industrial units as well as cost of living. Higher rates of vehicle tax results in higher all round cost conditions and thus retard the production and development of the country.

The existing transport facilities in India are appallingly poor. In the interior in many parts, road or rail transport is non-existent. This often results in local gluts while there is country-wide shortage. Therefore, there is no doubt an extreme urgency for the develop-

ment of transport and communications. And in fact it is gratifying that under the Five Year Plan, a sizable part of the public outlay is intended for this purpose.

But we are definitely opposed to a higher levy of vehicle and other taxes on transport for this purpose. While this can never be a major source of revenue under present conditions, it will cripple the transport industry and add to the cost burden of industry and trade in general. Therefore, we plead for a lowering of the Motor Vehicles Taxation.

The present position where there is multiplicity of authorities as well as taxes has been a cause of great inconvenience to industry and trade. With a view, therefore, to bring about uniformity over the entire country it is essential that there should be centralization of Taxation on Motor Transport.

A consolidated tax levied by the centre would be certainly preferable. The task of collection may be left to the states or municipalities and the allocation of the proceeds may be made on the basis of an integrated planning of road transport or in the alternative the centre should prescribe a reasonable schedule of various rates for Motor Vehicles in consultation with the States. All municipal taxes and other imposts should be abolished and the States should be allowed to levy taxes within the scale fixed by the Central Government.

Question 169

We are of the opinion that there should be no specific linking between proceeds from Motor Vehicle taxation and maintenance and development expenditure. The former should be viewed merely as an additional source of general revenue while the latter should form a part of the general public outlay.

Question 171

There is a need to bring to a line the motor vehicle tax and taxes on other types of vehicles. Animal drawn vehicles should also be taxed with a concession to those vehicles that use rubber tyres. Such tax should be collected by the States and credited to the Central Road Fund.

TAX ON CONSUMPTION OR SALE OF ELECTRICITY.

Question 176

We are in favour of a thin layer of sales taxation on the consumption of electricity by the general consumer for lighting and other domestic purposes. But a tax levied at the very source or a tax on the electrical energy consumed for industrial purposes would act as a check on production and is undesirable in the larger interests of the economy. In fact with the prospects of abundant supply of electric power after the completion of the D.V.C. and similar other projects, Government should devise ways of popularising electricity consumption for productive purposes. Therefore, we suggest that electric power consumed by industry should be exempted from this taxation.

Question 177

With a view to encourage consumption of electricity by small consumers it would be advisable to fix an exemption limit or in the alternative only a nominal tax should be levied upto certain limit.

Question 178

As stated in our answer to Question 176, we are opposed to any tax on electrical energy used for industrial purposes.

Question 179

Our above suggestions remain unaffected whether the electrical energy is supplied by the Government undertakings or by private undertakings or both.

Question 180

We recommend a uniform rate throughout the country. The fixation of rates and its administration should be vested with the centre and not the State.

PART VI

LOCAL TAXATION.

Question 195

There is evidently lack of co-ordination between the States and between the local authorities like the Municipal Corporations and each authority collects taxes to meet its own requirement even from same sources irrespective of their possible effects. This happens particularly in case of industrial establishments which are treated as the most fruitful source of revenue by such authorities and taxes are levied on them which in a way impair their competitive capacity, as compared to similar establishments either within the State or in other State as the taxes at lower rate may be imposed on them. The levy of multi-point Sales Tax by Bombay State is one of the instances. Further within the State of Bombay also Municipal Taxes are levied at different rates in the important centres like Bombay

and Ahmedabad. The Textile Industry at Ahmedabad already handicapped due to it being situated in an inland town is at a further disadvantage due to heavier local taxes as compared to other centres. We, therefore, submit that there should be greater co-ordination between these authorities in taxation matter so that uniformity as far as possible may be maintained.

Question 200

Yes. The scheme of rational system of taxation necessitates a thorough reorientation of our national system of taxation making the three fragments—Central, State and Local—by itself resourceful and self-sufficient. While fixing the rental value for the purpose of such taxation, due regard should be paid to all taxes, repairs and other outgoings of property owners including cost of rent collection, depreciation, etc.

Question 201

We agree with a view that there should be no change from the well-tryed basis of rental value to uncertain basis of capital value. In spite of some defects the annual rental value seems to be satisfactory for so many years.

Question 203

In our opinion, with a view to give impetus to house building in cities, some concession on general property tax should be given to Co-operative Housing Societies and new premises should be totally exempted from the levy of General Property Tax and Urban Immoveable Property Tax for a definite period.

Question 207

So far as "Service Taxes", e.g., water, lighting, drainage and conservancy taxes are levied along with and on the same basis as the general property tax, the tax charged must be such as would be required to cover only the expenditure incurred by that authority in providing such services.

We are of the opinion that the Port Trust properties, Railway properties, Central Government and other properties should be treated on par with other private properties for the purpose of property and service taxes.

Questions 209 to 214

In our opinion, Octroi Duty is preferable to terminal tax as on account of the provisions regarding refund, distributing agencies are not affected by it. As pointed out earlier there is a tendency among local bodies to levy Octroi duty at varying rates from Centre to Centre. In order to obviate such a position and to bring about uniformity we suggest that the Government should prescribe a model schedule of Octroi rates to be followed by the Municipalities. Exemption should also be uniformly applied. The formalities for obtaining refund, etc., should also be made very simple and expeditious. We are of the view that industrial raw material and Capital Goods should be exempted from Octroi Duty or duty at a very nominal rate should be levied on them.

Questions 217 and 218

In our opinion every effort should be made to reduce the cost of travelling. As such we are opposed to the levy of 'Pilgrim Tax'. 'Poll Tax' will also hardly fit in with our notion of free movement and is, therefore, undesirable.

Question 222

Before imposing betterment taxes, it should be decided in what proportion such expenditure should be

SUPPLEMENTARY MEMORANDUM PRESENTED BY THE AHMEDABAD MILLOWNERS' ASSOCIATION.

Question 35.—Further remarks by the Ahmedabad Millowners' Association.

SALT DUTY.

There is a strong case for the re-imposition of Salt Duty. Before 1947 the duty on salt used to provide a revenue of about Rs. 6 to 8 Crores. Paradoxically, with the abolition of salt duty, price of salt went up, but subsequently, during the recent years price of salt has come down and is at present below the pre-1947 level.

LAND REVENUE.

Surcharge on land revenue is as urgent as the imposition of agricultural income taxation. In Bombay state, for instance, the total land revenue hardly amounts to about Rs. 6 crores. The rate of assessment constitutes a bare 2 per cent. of the gross value of the produce. Even a 25 per cent. surcharge over the land revenue would only mean about 2.5 per cent. of the gross value of the produce, while on an average, sales taxation in urban and semi-urban areas amounts to more than 3 per cent. of the gross value. It is really unfortunate that many states such as Bombay, Madhya Pradesh, Uttar Pradesh and Madras introduced this surcharge and later on dropped it on political grounds. We sincerely hope the Taxation Enquiry Commission will prevail upon the State Governments to reintroduce this important source

of revenue, shared between the State Government, the Municipality and the Property Owners. In our opinion, the expenditure should be divided equally between the State Government, the Municipality and the Property Owners. In case of the latter, it should be spread over for a definite period.

Question 223

The Textile Mills in Ahmedabad are governed by the provision of the Bombay Provincial Municipal Corporation Act, 1949 and we have to offer following remarks on the taxation policy of the Ahmedabad Municipal Corporation as far as it affects the Textile Industry in this city.

(i) At present Ahmedabad Municipal Corporation does not supply water to all mills and certain mills have to make their own provision for supply of water by boring tube wells and installing machinery for lifting bore water. The Corporation, however, charges water rate from such mills on the ground that the mill is deemed to be connected with municipal water supply because the Municipality has laid their main within the prescribed area, though actually no water is supplied to them. This is unfair and the Corporation should charge water rate only where the mill is actually supplied water by the Corporation.

(ii) The Corporation Act came into operation in the year 1949 and the Ahmedabad Municipal Corporation applied their new Taxation Rules for the first time in respect of assessment year 1951-52. Apart from charging property tax on Lands and Buildings belonging to Mills the Ahmedabad Municipal Corporation also included for the purpose of Taxation Plant and Machinery of the mills in spite of the fact that no other Municipal Corporation in the country assesses Plant and Machinery.

The burden of Municipal taxes on Ahmedabad Textile Industry has been increased since 1939 by 300 per cent. while the burden of Municipal Taxes on other properties in the city has been increased only by 50 per cent. Such increase on the Textile Industry is unjustifiable and the Ahmedabad Municipal Corporation should treat all the properties situated within its limit on the same basis for the purpose of Municipal Taxes.

(iii) Section 406 of the Bombay Provincial Municipal Corporation Act, 1949 provides for hearing of appeal against valuation and taxes by the Judge of the Small Causes Court. The Act should be amended so as to provide for hearing and determining of the appeals by the Judge with the assistance of competent Assessors.

(iv) Rule 56(2) of Taxation Rules, Chapter 8 of the Bombay Provincial Municipal Corporation Act, 1949 provides for refund of 2/3rd amount of general taxes if a property remains vacant for not less than 60 consecutive days. In order to avoid misinterpretation of the term 'vacant' it should be provided under the Rules that mill premises containing machinery which has remained idle for not less than 60 consecutive days will be considered vacant and the owner will be entitled to refund as provided under the Rule.

which incidentally corrects to some degree the injustice done to industry and trade.

Question 37 (ii).—Further remarks by A.M.O.A.

It is important not to resort to any additional taxation that is likely to upset the cost of living. With the recent decision of the Government of India to revise the Index choosing 1948-49 as the base year, it would be appropriate to treat 1948-49 as a fairly normal year after the World War II and partition. In the interests of economic stability and planned development, it is necessary to maintain the cost of living around the 1948-49 level.

With the present comfortable position with regard to the supplies of food and clothing within the country, there is reason to believe that increased money supplies intended to create additional investment and employment will not produce any inflationary pressure on cost of living.

But if there is to be any additional taxation of essential commodities such as food and clothing, the effect would be very different. This is bound to result in a rise in the cost of living which in turn will result in demand for higher wages. Any such development would act as a disincentive to industry and prove deflationary, aggravating the present recession.

Taxation of luxuries and semi-luxuries at a steeper rate than at the present moment would considerably reduce wasteful consumption on the part of the upper class and perhaps also provide a sizable revenue.

**Question No. 103.—Further remarks by the A.M.O.A.
REVISION OF INDIAN CUSTOM TARIFF.**

The present frame-work of Indian Custom Tariff—Import Schedule—dates back to 1935 when it was completely revised. Since then, additions have been made to it from time to time on recommendations of Tariff Board and other considerations. Even with the enlarged structure which the Import Tariff has assumed today, it is not exhaustive enough to meet the complete requirements of the Import Trade which has largely developed during recent years. Though the Import Trade Control Schedule is linked with the Import Tariff, neither Schedule is exhaustive and the former embraces several categories of goods which do not feature in the Tariff and the interpretation of which has generally led to complications. The detailed groups and items under various sections of the Import Custom Tariff are in several cases not sufficiently elaborate and explicit for the purpose of modern trade practice and usages. There are numerous foot-notes in the Custom Tariff appended to different items making it difficult for the intending importer to know the exact rate of duty payable, particularly when in some of the foot-notes the references are made to certain notifications issued long time back. The present omnibus item 87 of the Import Tariff comprises a group of miscellaneous articles in various categories consisting of raw materials, semi-manufactured goods and manufactured goods, but these items from the point of view of their importance to the trade and industry deserve to be classified into appropriate groups.

It would be evident from an examination of the present Import Trade Schedule as given in the Hand-book of Rules and Procedure, how the difficulty of tracing or co-relating the corresponding item of the Import Tariff is encountered by the Government itself when against several items, it is indicated under the column of item of Indian Customs Tariff, that appropriate item of the Import Tariff should be referred (*vide* Item No. 122 of Part V and all the items of Part VI of the Import Trade Schedule). There are various items in the Import Control Schedule against which more than one corresponding entries of Customs Tariff has been specified. Examples may be cited of items like Machine Cloth (5A-Part III, I.T.C. Schedule), Zinc Chloride (1A-Part III), Coal Tar Dyes (1B-Part III), Belting for Machinery (28-Part II). These are only few instances but they can be multiplied. Further, Customs being the final authority in such matters, it is in the interest of importers that they should exactly know the rate of duty and the position under the Custom Tariff. The recent import of automatic looms by textile mills will be a relevant illustration of how importers are put to difficulty after importation when Customs hold a different view and put a different interpretation on the Tariff item. An Ahmedabad Textile mill imported automatic looms on the clear understanding that they were liable to duty at the rate of 5½ per cent. under Custom Tariff item No. 72(1) of Textile Machinery and Apparatus. The Custom Authorities, however, assessed them under Item No. 72(34) at the rate 10½ per cent. In doing so, they have interpreted automatic looms as Plain Looms which are subject to protective duty of 10½ per cent. *ad valorem*. The transactions have involved the mills to huge loss and have upset their estimated capital investment. It is really a serious problem for importers when costly items like machinery are subject to doubtful interpretation. Several items of textile machinery have been wrongly assessed as a result of confused interpretation. Milling Machine is used in textile mills in connection with the printing rolls. This machine is confused with Milling Machine used by factories and engineering works because of the similarity of name. Similar is the case with Engraving Machine used for preparing printing designs in textile mills, which is interpreted as Photo-engraving machine and assessed at a higher rate of duty. One machine is known as Rotary Cleaning Spindle which is used for cleaning spindles in spinning department of textile mills. Although this is an item of textile machinery and imported as such, it is assessed as an electrical equipment and charged at a higher rate of duty simply because it is operated by electric battery. Again Ball Bearing Top Roller is a spinning spare-part but it is charged at 90 per cent. duty on the value of ball-bearing fitted in the roller. In the case of last two named machines, the interpretation of the Custom authorities is incorrect because modern improvements in machines do not alter the character and the function of the machine.

There is one interesting example of confusion due to lack of proper co-relation between Import Custom Tariff and Import Trade Schedule. Item of 'boot and shoe grindery' falls under Serial No. 36 of Part I of Import Trade Schedule, it is assessed as an item of hardware under Custom Tariff No. 71. Serial No. 275 of Part IV of Import Trade Schedule relating to miscellaneous hardware corresponds directly to Item No. 71 of Custom Tariff. Import licences for boot and shoe grindery are sometimes issued under Serial No. 275 of Part IV of the Import Trade Schedule. Custom authorities take objection to this because the item of boot and shoe grindery is specifically mentioned in Serial No. 36 of Part I and re-

quire importers to produce licence accordingly. The Licensing authorities for these two Serial Numbers are different which creates confusion, delay and penalty.

The foregoing will make it clear how the Import Trade Schedule and Indian Custom Tariff are divergent and conflicting in some respects and to what extent such disparity affects the interest of importers and causes harm to the Trade and Industry. It is of vital importance to make the Import Tariff more elaborate removing the existing confusion and vagueness. It is therefore necessary to revise and enlarge the Import Tariff to make it more suitable to the present day pattern of import trade. There are various articles which have begun figuring in the Import Trade in recent years which need to be itemised and included in the Import Tariff. The present set-up of 22 sections may be retained but the structure of each section should be expanded, to make them comprehensive of all items. There is also a greater necessity to have a more detailed enumeration of commodities of all kinds and sorts under the different sections. There is, for example, a need for giving a detailed break-up of various chemicals, drugs and medicines and dyes included in Section VI, Machinery and apparatus and Electrical material given in Section XVI. This will obviate the difficulties of the importers at the time of clearance after importation. Such difficulties would be minimised by a more detailed description of items in the Indian Custom Tariff as figure in the Import Trade of the country.

Question 176.—Further remarks by the A.M.O.A.

The provision has been for levy of Electricity Duty in Part II of the Bombay Finance Act, 1932. Section 6(4) of the Bombay Finance Act, 1932 as amended by the Bombay Finance (Amendment) Act, 1949 reads as under:—

"(4) Every person other than a licensee who generates energy for his own use shall pay to the Provincial Government at the time and in the manner prescribed the proper electricity duty payable under this Part on the units of energy consumed by him."

Nothing in this sub-section shall apply to any person who generates energy for the purpose of supplying it for the use of vehicles or vessels.

Under the provision of this sub-section, Electricity Duty is collected by the State of Bombay from Ahmedabad Cotton Textile Mills generating power for their own use. This is a retrograde form of taxation amounting in effect to a tax on industrial progress and is against the declared policy of the Central and the State Government to make electricity cheap.

**Question 223 (i).—Further remarks by the A.M.O.A.
The charging of water rate by the Ahmedabad Municipality from mills without actual supply of water.**

The Ahmedabad Municipal Corporation is governed by the provisions of the Bombay Provincial Municipal Corporations Act, 1949. Section 130 of the Bombay Provincial Municipal Corporations Act which relates to "Water Tax on what premises levied" reads as under:—

"130 (1) Subject to the provisions of Section 134, the Water Tax shall be levied only in respect of premises—

- (a) to which private water supply is furnished from, or which are connected by means of communication pipes with, any municipal water works; or
- (b) which are situated in a portion of the City in which the Commissioner has given public notice that the Corporation has arranged to supply water from municipal water works by means of private water connections or of public stand-posts fountains or by any other means."

Under the provision of Section 130 (1) (b), the Ahmedabad Municipal Corporation is charging water rate at 2½ per cent. of the rateable value from the Cotton Textile Mills even in cases where water is not actually supplied to them and the mills have to provide their own borewells for their requirement of water, on the ground that such mills are situated in a portion of the city where public stand-posts are provided.

Question No. 223 (ii).—Further remarks by the A.M.O.A.

The burden of Municipal Taxes on Ahmedabad Textile Industry has increased since 1939 by nearly 800 per cent. as against increase on other properties by 50 per cent. during the same period.

NOTE.—Property Taxes on Ahmedabad Cotton Textile Mills are at present levied under the provisions of the Bombay Provincial Municipal Corporations Act, 1949. The amount of taxes assessed for the year 1951-52 comes to Rs. 32,17,883 including an amount of Rs. 4,77,857 of the property tax on certain plant and machinery, which is an item included for the first time for the purpose of municipal taxation not only in this Centre but also in the Country. The same mills paid a total taxes of

Rs. 2,94,489 for the year 1939-40 on lands and Buildings (as machinery was not a taxable item under the previous enactment, the Bombay Municipal Boroughs Act, 1925). Thus the total increase in the burden on mills in respect of Municipal property taxes comes to about 800 per cent. (from Rs. 2,94,489 to Rs. 27,40,026). Such an enormous increase in taxes has been brought about by adopting a method of double taxation as detailed below:

Year.	G. W. Rate on Factories.
I. Up to 1939	1% on capital value.
As revised in 1939-40	3% Do.
„ „ in 1943	1½% Do.
„ „ in 1947-48	1½% Do.

II. Increase in capital value of Land 100% and Building Over 1939.

III. New imposition of 'Special Sanitary Tax' resulted in rise of tax by 50% over amount paid in 1939.

As against this the rates of taxes on residential properties during the period has been as under:—

Year.	General Water Rate.	Special Water Rate.	Drainage tax.	Total
Pre 1939	5 %	5%	5%	15 %
1943-47	7½%	5%	5%	17½%
1947-51	11½%	2½%	3½%	17½%

New Valuation:

General	Conservancy.	Special rate.	Water.
12%	3½%	2½%	18%

Further as a result of increase in value of the Land and Building, the burden of Urban Immoveable Property tax levied by the Government of Bombay on mill properties has also gone up. The amount of Urban Immoveable Property Tax paid by the Textile mill industry for the year 1951-52 amounted to Rs. 6.16 lacs as compared to Rs. 5.69 lacs in the year 1940-41.

The Municipal Corporation has further introduced Octroi Duty in place of Terminal Tax formerly levied by its predecessor the Boroughs Municipality. The income of the Municipality from this new source of revenue has been Rs. 51.62 lacs in 1952-53 as against the receipts of Rs. 14.39 lacs in 1949-50 from the terminal tax. As most of the raw materials and stores purchased by the textile mills are liable to the levy, the burden of Octroi duty falls very heavily on mill industry.

General Observations.—Further remarks by the A.M.O.A.

The extent to which the burden of particular taxes is borne by the industry during the period of depression is dependent on the degree of the slump. The taxes on production, i.e., import duty on cotton and other mill-stores, State and Municipal Taxes, etc., are concerned, are included in cost of manufacture and hence it is not possible to visualise to what extent they fall on the manufacturer in a seller's market. Taxes on sales, i.e., Excise Duty, Handloom Cess and Sales Tax which are ordinarily to be paid by the buyers, are the major burdens which are shifted partially or wholly on the manufacturer in times of depression. This would be clear from the following:

In the middle of 1953, Ahmedabad Cotton mills and trade were in the grip of unprecedented trade depression, which had resulted in heavy accumulation of stock. As there was very little demand in the market even at prices below par, the Maskatin and Panchkuvva Cloth Markets Associations approached the Ahmedabad Mill-owners' Association with a request that member mills should not separately show Sales-Tax in their bills in all future transactions till the conditions returned to normal and the Association had to agree to the proposal. Though it was a condition of the agreement that mills may quote a higher price inclusive of Sales-Tax, it did not give any benefit to the mills which had to quote prices exclusive of the Sales-Tax and had itself to carry the burden of the Sales-Tax.

The agriculturist comes into the picture only when slump in the textile trade is reflected in the price of cotton. However, chances are meagre for such an occurrence as the present crop of Indian Cotton is in the vicinity of 48 lacs bales per year, which is less than the demand of mills for such cotton.

A MEMORANDUM BY THE AHMEDABAD MILLOWNER'S ASSOCIATION, AHMEDABAD.

(1) Replacement Needs.

The total amount required for Rehabilitation and Modernisation of entire Block by the Ahmedabad Textile Mills comes to Rs. 69.57 crores, calculated at the current prices, viz., 3.5 times the prewar normal price, on the basis of the Block (Plant and Machinery and Buildings) as in year 1947 and after taking into account the surplus available in that year. If the surplus of Funds available with the mills at the end of year 1952, viz., Rs. 15.69 crores is deducted from the total reserves required for Rehabilitation, etc. viz., Rs. 69.57 crores, the balance viz., Rs. 53.88 crores shall have to be provided for by the Industry in the course of next ten years.

The amount of Reserves required as above is calculated in the following manner:—

BASIC YEAR 1947.		(Figures in Crores.)
Block	53 Mills.	22.70
Machinery	15.96	
Buildings	6.74	× 3.5
		79.45
Paid-up Capital		7.62
Depreciation Fund		14.29
Reserve Fund		7.87
Premium on Shares		.86
Machinery Renewal Fund		1.94
		32.58
Less: Block		22.70
	Surplus in 1947	9.88
Total Replacement value		79.45
Less: Surplus in 1947		9.88
	Reserve required	69.57
Less: Surplus available at the end of 1952		15.69
	Reserve required for Rehabilitation in next 10 years	53.88
		÷ 10
	Reserve required for Rehabilitation per year	5.39 i.e. 5.4 crores

(2) Sources of Financing.

The main source from which Reserves required for Rehabilitation and Modernisation of Plant and Machinery and Buildings can be built up by the Ahmedabad Mills is the surplus of profits of the year. However, looking at the trend of earnings of the mills during the last two years, it is doubtful if the mills would be able to set aside every year for the next ten years amount of Reserves required for Rehabilitation, as would be evident from the picture of the Industry for the year 1952 as given hereunder:—

YEAR 1952.		(Figures in Crores.)
Gross Profit (43 Mills)	59 Mills.	3.23
Less: Loss (16 Mills)		.73
	BALANCE	2.50
Less: Statutory Depreciation (59 Mills)		2.88
	Deficit	-0.38
Less: Income Tax @ 6.95 annas in a rupee on net profit of 22 mills (1.32).		0.57
		-0.95
Less: Reserve required for Rehabilitation.	4.45	
Less: Statutory Depreciation	2.88	1.57
		-2.52
Less: Interest @ 6% on Paid-up Capital. (59 Mills). (14.00 × 6%).		0.84
		-3.36
Less: Return @ 2% on Working Capital. (59 Mills). (15.39 × 2%).		0.32
		-3.68

If, in view of the receding profits of mills, the total amount required for Rehabilitation is to be spread over years instead of 10 years, the condition would be far worse as by the end of 15 years, the Machinery which installed after year 1947 would have been worn out and would require replacement in addition to the Machinery working in year 1947. The Industry shall have to make further provision for Capital employed in working, the available surplus would be used up in replacement at the end of the period of 15 years.

Such a position can be avoided by taking to Reserve all surplus profits every year after providing for prior charges but without making any provision for Bonus or for extra dividend till the total amount required for Rehabilitation is built-up. Once this self-efficiency is attained, provision may be made for distribution of Bonus and for extra dividend, if desired.

Another source from which mills' requirement of Funds for Rehabilitation can be financed is by providing for grant of loans to the undertakings for Rehabilitation and Modernisation.



सत्यमेव जयते

All India Co-operative Union, Baroda

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

1. Your Commission, having invited opinions from different quarters, regarding the basic principles that should govern any sound Taxation Policy of a Government, we take this opportunity of enunciating our views thereon, in general.

2. The Scheme of reply.

But before we begin to proceed to our task proper, we can do nothing better than point out to the Commission that the scheme of our replies would not follow the ordinary routine procedure of replies to the questionnaire, question by question, *seriatim*, but that at the outset we will offer our observations on the policy in general, and then take up enumerating specific reasons for specific types of taxes, besides the general grounds already mentioned.

3. The objective of a sound taxation policy.

The main objective of a sound taxation policy, to be adopted by the Government, should be to evolve such a scheme that, besides obtaining necessary revenues for running the Government itself, it also indirectly and automatically aids those types of activities which the Government thinks are essential for developing the country, as a whole. Civilized governments, all over the world, accept this principle, as the prime moving force, that those movements and activities which they want to foster and further, are helped in a substantial way. This help may be of two kinds, direct and indirect. Indirect help, however, has always been recognised as the healthiest type of help, free from all prejudices and grumbings. We humbly beg to bring to the notice of the Commission that this principle was also accepted, in a greater or less degree, by the Indian Government, previously. The Government then thought that India being an agricultural country, in the main, was to be industrialised. In order to bring this policy into execution, it framed its Tariff policy, and maintained rates of taxes, in such a way, that it indirectly and automatically helped the movement towards industrialisation. Our humble submission to the Commission, now, is that, while proposing recommendations to the Government, it does not lose sight of this basic principle, governing the taxation policy, and recommend such taxes as would, indirectly and automatically, help the Co-operative Movement, which the country, as well as the Government, wants to foster.

4. Co-operative Commonwealth—The Ideal before the types of business concerns.

After winning of Swaraj, the Country has placed before itself, the ideal of achieving Co-operative Commonwealth, as its ultimate goal. The co-operative movement tries to achieve this ideal. It is, therefore, in the fitness of things that the Government should assist it in its efforts for reaching the goal.

5. Co-operation—an instrument for implementing Government Programmes.

Apart from the ideal placed before the country, and which the country is trying to carry out, in its own way, the Government has, accepted various policies and framed developmental programmes for the development of the country. There is a method and machinery by which the Government is trying to fulfil these policies and implement these programmes; but the people in general, we beg to point out, have, in their own popular way, forged out an instrument, in the form of the Co-operative Movement, and placed it at the disposal of the Government for fulfilling its various policies and implementing its developmental programmes; and, in doing so, it has so completely identified itself with the work of the various development departments of the Government that it has practically come to be looked upon as an extension of the Government departments, carrying out these developmental programmes, which really speaking it is not. Under the circumstances, it is just and fair for the Government to share the cost of the movement.

6. Agricultural finance is the primary obligation of the Government.

In building up the economic frame-work of a country, the two chief productive sectors, *viz.*, the Industrial and the Agricultural, remain as the pivots on which all its activities are made to hinge; and, in a country, like India, where nearly 80 per cent. of the population are engaged in agricultural operations of one kind or the other, the Agricultural sector is bound to claim the topmost priority; and rightly, too, has it been recognised, as such, by the present popular Government. Not only does it want development therein, in patches, here and there, but it is

all up and doing for modernising and mechanizing same, from the top to bottom.

In this connection, the problem of Agricultural Finance has been the most perplexing one, and it always loomed large before the Government. The ingenious money-lender, the Sahukar, who was there in field as the sole monarch, actually overdid his business and exploited the ignorant farmers, as a class, so much so that the Government itself was feeling insecure about its own land-revenue, the main source of its income from that class. Under the circumstances, the Government tried to step into the field, and began to advance financial assistance, known technically as the Tagavi Loans to needy agriculturists, partly by way of safeguarding share in the revenues, and partly by way of assisting them in their own agricultural operations. The assistance, however, served little purpose, and was soon found to be inadequate both ways; the method of realising same, at the same time, being more cumbersome and inconvenient. It, therefore, did not find favour either with the lender, or with the borrower. The Government then approached the Commercial Banks and tried to prevail upon them for shouldering the responsibility of financing the agriculturists. But they, being the most conservative calculators that they were, and being convinced of all the hard risks involved in such undertaking, refused to be persuaded so easily. The Agriculturists, as a class, however, felt still stranded; and it was just at this juncture that the idea of a co-operative effort flashed on the horizon. The Government, then in power, espoused it in right earnest. Co-operative Credit Societies, accordingly, came to be formed in the country, for the sole purpose of providing agricultural finance to the members thereof, at an increasingly low rate of interest. After war and the attaining of Independence, the entire outlook on the problem of agriculture was changed. The policy of 'grow more food' was advocated with full vehemence, more land was brought under cultivation, the method of agriculture was to be modernized and mechanized. This required more finances. But, it must be said, to the credit of the movement that it continued its efforts valiantly, inasmuch as the entire burden of finances, at this time, fell on its shoulders alone, the money-lenders having withdrawn themselves from the field, owing the hard and risky regulating measures imposed upon them, consequent on the passing of the Money Lender Act and the Debtors Relief Act, and the Commercial Banks having refused to go to the rural areas. The co-operative movement, thus, has stood alone, and discharged its duties admirably well, among the rural areas. We therefore, hold that if the 80 per cent. of the population is to be kept alive, if the rural areas are to be developed in earnest, the hands of the co-operative movement should be strengthened not merely by allowing them to enjoy the concessions, and exemptions, already in existence, but by making them more liberal and more extensive. If this is not done, the whole structure of agricultural finance will collapse, and end in disruption.

7. Popularising Banking in the Country side.

Along with the work of providing financial assistance to the agriculturists, the existence of primary Credit Societies, in the far off villages, serves another very useful purpose of popularising Banking in the remotest rural areas. It makes the entire population thereof bank-minded, and trains the people up in invoking banking practices in their ordinary dealings. As a rule, the capital in the villages is always almost wholly blocked up as lying idle. But the village primary mobilises it, as makes it moving, among the people served by it. Even primary may, accordingly, be rightly denominated as Bank in miniature. The Commercial Banks were approached to open their branches in the country side. But they asked for heavy subsidies in return. The Co-operative Movement, on the other hand, having penetrated in the innermost recesses of the country, has, undertaken this work voluntarily. It, therefore, deserves more substantial assistance.

8. Formation of fresh capital.

In bringing about economic reconstruction of the country, as a whole, formation of fresh capital plays a leading and vital role. The Government wants capital. It must obtain it in a healthy and scientific manner. Floating of big loans, and approaching foreigners for subsidising efforts at home, may well seem attractive, as helping expeditious disposal, but, in the end, they strike at the root of the foundation of the structure the Government wants to erect. It is only the co-operative type activity, which, in this aspect of the economic reconstruction drive, too, leads all the rest and tops the rank.

builds up a fresh form of capital form within, and entirely voluntarily. It is a peculiar type of capital, unknown hitherto. It is not owned by individuals, but by a corporate body, and cannot be utilised, under any circumstances, for individual advantage. It has to be utilised only for social and public purposes, even after the disposition of the body. There are certain salient features in the management of the funds of a co-operative society, which go to build up its capital, as stated above:—

- (i) The dividend it distributes on the capital invested is always at a low rate.
- (ii) From even the profits it makes at the end of the year, there are definite portions which have to be allocated to specific types of funds, in accordance with the provisions laid down in the bye-laws, nothing going for individual benefit.
- (iii) The rest of the savings builds up its reserves.
- (iv) Compulsory savings deposits.
- (v) Voluntary savings deposits.
- (vi) and other local deposits, all these add to the amount of the capital formed.

The capital, so formed is also made available to the Government, in-as-much as the societies invest their funds, partially if not wholly, in Government securities and Government loans.

Tapping of rural savings.

It is the policy of the Government to see that the savings in rural areas are utilized for beneficial purposes, and not frittered away in unnecessary luxury, nor left idle. It, therefore, aims at tapping the rural savings best as it can. The National Savings Certificate drive is a movement, started with this aim in view, and it has been pushed in a way, in tapping the Savings to some extent. The persons, however, engaged in carrying on this movement, remain at a distance and contact the people personally only in so far as this movement is concerned. The rural primaries, on the other hand, work wonders. The people themselves are always in direct contact with the people. The people themselves have brought them into being. These primaries, therefore, tap these savings, in a very satisfactory way, and from all the sides. In fact, they have tapped such savings to a very great extent, and are still tapping the same, at an increasing rate. It is, therefore, a movement that the Government should help this activity, in the best as it could by helping the Movement itself.

Government's preference for institutional type of business.

As a measure for minimising unnecessarily large amounts of expenditure, the Government always prefers associational or institutional types of business, in-as-much as it saves the botheration for collection of taxes, check of evasion of taxes, etc., and makes itself amenable to effective control. The Co-operative type of business, by its nature and content, is nothing but an institutional associational type of business. It, therefore, supports the Government standpoint, and implements its policy, in that line.

Even distribution of National Income and raising the purchasing power of the people.

The present Government, being democratic, in all its aims and purposes, aims at distributing the National Income evenly. Taxes are a proper device for drawing in the hoards of income, piled with the chosen few, and using it to distribute the same evenly. But they leave the mass untouched. The Co-operative Movement, reaching spread far and wide into the remotest corners of the Indian villages, is best suited to bring about such distribution among a class, which, unfortunately, till now, remained down-trodden under the heels of persons, known as Middlemen. In the ordinary course of business, the amount of profit goes to the Middlemen, both the producer and the purchaser being left helpless in the market. Things have changed, since Co-operation made its advent in the field of marketing. It places the producer in direct contact with the purchaser, and eliminates the intermediary altogether. In doing so, it secures better prices for producer and fairer prices for the purchaser. This sort of activity, accordingly, inherently increases the purchasing power of both. Raising the purchasing power of the people is recognised as one of the surest ways of relieving, or at least minimising, the acute distress felt all round, about the problem of unemployment to-day. The Co-operative Movement, thus tries to solve the burning question of the day. The acute distress is lessened in another way, in so far as the Movement makes money available at very low rates. Thus, the Co-operative Movement substantially aids the Government in fulfilling its policy of even distribution of National Income. It, therefore, deserves to be materially helped.

Co-operation, a check on corruption.

The Government wants to check corruption. There have been legislations about the same; there have been drives, such as the anti-corruption drive, for the same.

The former seem hardly to have made any effect yet; the latter do not seem to have fared better. The Co-operative Movement helps the Government in this respect also. A co-operative institution has to maintain very accurate accounting, is subject to close Government supervision, inspection and audit, and thus leaves hardly any scope for resort to corrupt practice. We may illustrate this by a concrete example. Suppose that there is a great scarcity of Railway wagons for transport of commodities. A private or individual trader, under the circumstances, will not desist from stooping to any corrupt practice for claiming priority of wagons. Whereas, under similar circumstances, it will be impossible for the co-operative institution to act in a similar fashion, even though, in so doing it places itself in a disadvantageous position and suffers loss. Therefore, the Government should compensate the Co-operative Movement for remaining firm and honest in its dealings with the administration.

13. Profits of Co-operative Societies are due to honorary workers.

A very salutary result of the Co-operative Movement is that it has brought in its train a band of workers, selfless and untiring, who offer their honorary services to the institutions that spring up, and guide their destinies all along. It may be pointed out that the profits appearing in the accounts of most of the Societies, at the end of the year, are mainly due to the fact that these honorary workers accept no remuneration for the services rendered. The Government, therefore, should not think of taxing such seeming profits, otherwise it would take away a very valuable incentive of rendering selfless service from such types of people.

14. Co-operative Societies and abnormal times.

In all that has preceded, we have talked about the part played by the Co-operative Movement in ordinary normal times. But abnormal times do arise, and we have had sufficient experience of the same, both during the war and after the war. The part played by the movement in such times also should be accounted for, and there is a bright history about the same which should give glory to the movement. When Madras, e.g., was actually bombed, during the second world war, and when all other big, bigger, and biggest concerns of the city closed their doors and sought shelter elsewhere, the Triplicane Co-operative Multi-purpose Society stood alone, unshaken, and catered to the needs of the people, as best as it could. This was a monumental stand, indeed. The movement lent a very helping hand to the Government, in abnormal times. It looked after the Civil supply work, entrusted to it, very ably and satisfactorily. The evil of black-marketing was checked mainly through the agencies of these co-operative societies, though at great risks to themselves. This would provide a very sound reason for subsidising the Movement.

15. Co-operation—a training ground for Democracy.

Democracy, in India, is of recent origin and in its infancy. The whole mass has to be trained up for the ways of democratic thinking, and the methods of democratic acting. It may be pointed out, in this connection, that the co-operative movement works on essentially democratic principles. Every Co-operative institution, big or small, whether in a big city or in the remotest village, is accordingly, a training school for democratic methods of work. As such, the Government attitude to such a movement should be liberal and sympathetic.

16. Co-operative Movement distinguished from other types of business concerns.

The Co-operative Movement can be easily distinguished from other types of business concerns as under:—

- (i) That the rate of interest allowed on the issue of share capital is a positively fixed rate,
- (ii) That there is restriction in the number of shares each individual can hold on his own account,
- (iii) That there is restriction on the distribution of dividend,
- (iv) That the management is essentially a democratic one, membership being open and universal, being elected on the principle of "One man-one vote—none by proxy",
- (v) That the amount, left after payment of dividend, is utilised for building up reserves,
- (vi) That such funds are owned by the Society, and there is no scope for any individual for appropriating profits for his private purposes,
- (vii) That even after dissolution, funds could be utilised only for public purposes, or for organising or strengthening similar institution in the same locality.
- (viii) Its accounts are audited by the Government.

Whatever Taxation Policy, therefore, is proposed to be forged out on the anvil, the policy-framers cannot afford to lose sight of the deep line of demarcation which

separates a Co-operative concern from all other types of proprietary concerns. The policy, under the circumstances, should be so framed as to help the Co-operative Movement, and certainly not to put the same into adverse position, as compared with other business concerns.

17. Justification for claiming concessions, exemptions.

After having dwelt at so much length on the nature and importance of a co-operative type of effort for the political, social and moral uplift of the people at large, our task becomes easy and justified in claiming for it not merely the concessions, exemptions and facilities, enjoyed till now, but an enlargement of the same on a broader basis. Historically, the movement has been allowed to enjoy certain concessions, exemptions and facilities, from its very inception, and even at the hands of a Government, alien to the soil, the Britishers. The claims for assistance must be more easily acceptable, we believe, to the present Government, which is run by the people themselves.

Having offered our observations, so far, on the Taxation Policy in general, as applied to Co-operation, we now proceed to deal with specific taxes.

I. Co-operative Societies and Income Tax.

Besides the general arguments, the following are the specific reasons for granting exemption from Income Tax:

- (1) The income that would be derived from income tax, proposed to be levied from the co-operative societies, all over the country, would be very insignificant; whereas the step would act as a serious blow to the incentives to people to form co-operative societies. Thus, the loss which the movement will suffer thereby will far outweigh the gain the Government hopes to get, by imposing the tax on the societies.
- (2) There would be another difficulty also. The members of the societies are mostly persons of small or ordinary incomes. In and by themselves, they would not have been liable to tax. But as the Tax is collected at the source, the shareholders of the societies would be obliged to ask for refunds. Almost 99 per cent. of them belong to that type. The process, again of approaching the authorities concerned for such refund, is so long and laborious that hardly any one of them would go in for the same. This process would be inconvenient to the Income-Tax authorities also.
- (3) Profits of the co-operative societies are really speaking no profits at all. They are ultimately returned back to the members, either in the form of belated payment in the case of marketing societies or in the form of price rebates in the case of Consumers' societies. Whatever profits are left after these payments and payment of dividends at a rate not higher than 6 per cent. to the shareholders, are not for distribution among the shareholders.
- (4) Profits, appearing in the accounts of the societies, are as a matter of rule, distributed strictly in accordance with the provisions of the bye-laws, which provide for declaration of dividend at a rate not more than six per cent., and besides which all the amounts that are left are utilised for building up reserves. No individual appropriation of these profits is possible. The reserves can only be used after obtaining necessary permission of the Registrar. Even after dissolution of societies, all these funds could be utilized only for social purposes, or organising similar institution in the same locality.
- (5) Exemption from Income Tax is claimed on two grounds, viz., on principle, as well as, as a matter of concession.

On principle, the profits of a co-operative society are not strictly speaking profits at all, in the ordinary sense of the term. This has been recognised in countries, like England and elsewhere. Though Co-operative Movement is well developed there, still some exemptions from Income Tax are allowed, as a matter of concession.

- (6) For purposes of Taxation, it is laid down that profits derived from dealings with non-members are liable to tax. This question arises only in the case of distributive-supply-societies. As a matter of fact, these societies are not working for profits, at all. A very major portion of the profits, accruing to these types of societies has to be ear-marked for what is known as the Special Development Fund, which cannot be utilised otherwise than for public purposes. Tersely put, these are all mutual aid societies, and mutuality in trade is no profit-making business.

- (7) It is also laid down, for the purposes of taxation that the income derived by the co-operative societies, out of investments of their fund into Government securities, is liable to tax. The tax would have been justified, if the investments were made for trading purposes or for earning profits. As a matter of fact however, these investments are made as a matter of course and routine, and in pursuance of healthy banking practice. So the Co-operative Movement claims complete exemption from the tax.

- (8) Deposits in rural primaries should be tax-free just on the same basis as the National Savings Certificates, which are issued tax-free. This would certainly go a great way in aiding the scheme of tapping the rural savings.

- (9) Lastly, we would humbly bring to the notice of the Commission that the analogy of the state of affairs, existing in countries, like England and Sweden, elsewhere, in this matter, should not be applied to India, for the following reasons:

- (a) The movement in those countries has developed to its fullest extent; the people are educated and advanced. Therefore, not so much clamour there for exemption from Income-tax.
- (b) Even in such countries, certain exemptions are granted to the movement.
- (c) Moreover, in those countries, the movement is not being utilized as an instrument for Government policies and programmes just in the way in which it is being done in India. In India, therefore the movement deserves complete exemption from Income Tax.

II. Co-operative Societies and Agricultural Income Tax

We are of opinion that the income tax on agricultural holdings should not be levied. If, however, the Government thinks of levying this tax, we believe that it would be unwelcome, on the following grounds:

- (1) It creates a curious anomaly. The Government desires that agriculture should be developed on a co-operative basis. This cannot be done otherwise than by introducing co-operative farming. But the imposition of agricultural income tax will discourage people from forming themselves into Co-operative Farming Societies, because if they remained as individual farmers, with their small holdings, they would not have been liable to pay tax, whereas as their becoming the members of a Co-operative Farming Society makes the society liable to pay tax.
- (2) The Government, at present, patronizes agriculture, wants to modernize it, and introduce large-scale farming instead, as the holdings of agriculturists are too small. But this cannot be materialised, unless people are convinced that the introduction of such farming will be to their benefits. Large-scale farming will undoubtedly bring more income to the society. But if that income is going to be taken away by the Government, in the form of agricultural income tax, people would certainly be discouraged from bringing such societies into existence.

III. Co-operative Societies and Land Revenue.

The following reasons may be advanced for claiming exemption:—

The Co-operative farming has yet to be ingrained in the soil of India. It is a new experiment which has to be popularised. It therefore deserves encouragement in the first instance, by ensuring concessions in the rate of land revenue. Complete exemption is suggested for the first two or three years, and then progressive exemptions, spread over for a number of ten years.

IV. Co-operative Societies and Surcharge on Land Revenue.

The surcharge, if at all to be levied, should be levied proportionally, and not progressively, so as not to put the farming societies into any adverse position, as compared to individuals, in-as-much as, the societies would have to pay great amount of surcharge on their holdings which would be generally larger than those of the individual farmers.

V. Co-operative Societies and Stamp Duty.

The following reasons can be advanced for claiming exemption from stamp duty:—

- (i) A Co-operative Society, as a rule, institutionalises business and introduces banking practices even in the remote rural areas. This type of business, and these practices require a number

small and variegated kinds of operations to be performed. All these operations will require to be stamped; and that would make the process more expensive in the aggregate than in a single big operation, which would deter the movement from penetrating into remote rural areas.

- (ii) The main business these societies undertake is that of financing. And financing at a rate, the lowest in the market, to agriculturists, staying in the far off villages, is a very risky job. Stamp Duty will add to the burden, and will not make agricultural financing cheap.
- (iii) The Government, in advancing tagavi loans, forgoes this type of duty. There is no reason why co-operative societies should not be allowed to enjoy a similar latitude.

VI. Co-operative Societies and Registration Fees

The Co-operative movement introduces banking practices in the far off villages and institutionalises even small businesses in the rural areas. It is already enjoying exemption from registration fees. Now if this is taken away, this type of work will receive a great set-back in as much as the registration affair will involve an additional expenditure of transport and travel on the grant of the institutions concerned.

VII. Co-operative Societies and Sales Tax.

The imposition of Sales Tax on co-operative societies gives rise to a peculiar anomaly, which may be illustrated by a concrete example. A private individual, selling milk, e.g., in a remote village, may not have to get himself registered, under the Sales Tax Act, as his annual total turnover is not likely to reach the target, fixed under the Act, whereas if ten or twelve milk-men, residing in the same village combine and form themselves into a society, it will have to get itself registered, as its total turnover is likely to reach the target earlier. Thus, the taxable limit for co-operative societies should be raised considerably. Otherwise, it would dissuade people from forming co-operative societies, and place the societies in an unfair position, as compared to individuals. Hence we submit that care should be taken that no tax is

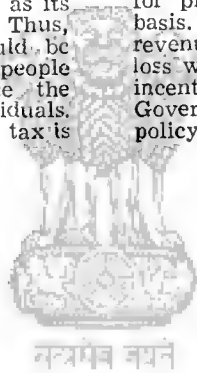
to be imposed which would put co-operative societies into adverse position, as compared to individuals.

VIII. Co-operative Societies and Property Tax.

Property tax, in so far as it is related to co-operation, is concerned mainly with Co-operative Housing Societies. Providing dwelling accommodation to the people of a country is one of the principal obligations a Government has to fulfil. The present Government has sympathetically taken up the problem, and put into operation several building programmes. Its main concern is to see that the tenants are not exploited anywhere. One of the ways in which this can be ensured is to push forward the programme on a co-operative basis. But if property tax is to be levied on the society, it will dissuade people from coming forward to form such societies. A member, if he would have built the house himself, would not have been taxable. But a combination of several such members, forming themselves into a society would make it taxable. This is very paradoxical. It may, therefore, be fitly claimed that these societies should be exempted from property tax.

IX. Co-operative Societies and Commodity Taxes.

There are two kinds of commodity taxes—Import duties, and Excise duties. The Government proposes to bring about development in agriculture, on all fronts. Large quantities of foreign materials will have to be imported for this purpose. The commission, we hope, will give due consideration for recommending concessions for agricultural development in general. The same concessions will naturally and automatically extend to co-operative farming. So far as the excise duties are concerned, our plea would be that a rebate to such societies, as the Co-operative Producers' Society of Bidli makers or Match makers, in the excise on tobacco and matches, in proportion to the raw tobacco used or matches produced, will provide a very healthy incentive to efforts for production of such commodities on a co-operative basis. If the Government will have to bear loss of revenue on account of these concessions, we are sure, the loss would be quite insignificant in comparison with the incentives that would otherwise be encouraged. The Government, therefore, may well be advised to revise its policy, on this score.



Banaskantha Jilla Khedut Mandal.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

- (1) It is not at all fair to levy any tax in the form of revenue assessment over the agricultural land. The expenditure incurred after agriculture should be deducted and the net income should be calculated. From the net income, the amount that would generally be required by the agriculturist-family, should be deducted and only on the remaining amount the income tax be charged.
- (2) The limit of the amount of agricultural income for the purpose of charging income-tax, should be fixed at a higher figure, than that of non-agricultural income.
- (3) The rate of Tax should be more in respect of those holding land which may be in excess to the requirement for the maintenance of agriculturist-family, and the relief in the rate to that much extent be afforded to those holding less land.
- (4) In the case in which whose *main* source of income is from non-agricultural income, the income-tax be charged on the total of both the non-agricultural and agricultural income.
- (5) In case the revenues is to be recovered, the same should be recovered in the form of foodgrains in respect of the land in which foodgrains are produced and also looking to the proportion of the yieldage therefrom.
- (6) The manner in which the revenue in the form of foodgrains be recovered should be as under:—
- First of all the average rate upon the last five years' market rates of food-grains should be worked out. Then, the quantity of foodgrains that may be procured against the actual revenue assessment, at the above-mentioned average rate, should be taken as permanent Land Revenue Assessment and only that much quantity of foodgrains should be taken as Land Revenue so that on the occasions of slumps in the market, agriculturists may not.
- (7) In case the cultivation is done for money-crops in a particular land, the assessment in respect of such land, should be kept at a higher rate and in case of foodgrains and other edible items, the assessment be kept at a lower rate.
- (8) In case of the yield of the year being 4 annas or less than that, the whole amount of revenue assessment should be remitted.
- (9) In case of the yield of the year being over 4 annas and not above 8 annas, than only half of the revenue assessment be recovered.
- (10) When the year is 12 annas the full revenue assessment should be recovered.
- (11) In case in which yield of the year is over 12 annas the full revenue assessment *plus* the arrears of previous year, if any, should be recovered.
- (12) Income-tax should not be charged on the amount of irrigation rates for supplying water to the land in which such watering is done.
- (13) No sur-charge or any cess be levied on irrigation-rates.
- (14) In some suitable case, the recovery of the Land Revenue Assessment should be entrusted to Gram Panchayats, or Co-operative Societies, or such other local Bodies.



Bhal Nalkantha Khedut Mandal.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART IV.—AGRICULTURAL INCOME TAX, LAND REVENUE AND IRRIGATION RATES AND BETTERMENT TAX.

GOVERNMENT POLICY OF TAXATION.

Taxation Policy of Government should be such that the tax should be imposed on those who can afford, and the realisation of the tax should be utilised for the economic, social and cultural welfare of the poor ignorant and backward classes, and they can enjoy equal rights and opportunities in every walk of life. With the above view point, the income received from taxation should be utilized. Thus average income of the state should be increased and all sorts of inequalities from every field of life should be done away with. The existence of Government should be for this purpose.

Taxation of Land.

Land is neither the means of consumption nor comfort, but it is the means of production of necessary things of life. Man has to labour hard on the land. He has to face innumerable risks and has to put up with natural and man-made hardships. We definitely believe that there is no justification in imposing a tax on the means of production of basic needs of human beings. No doubt the ultimate ownership of the land is the state. But that does not mean that the state should levy tax on land. The acceptance of the ownership does not only depend on payment of taxes, but the state can affirm its ownership by framing certain other rules.

We also believe that the object of taxation should not only be to increase the income of the State. But it should rather increase the average national income and especially it should result in securing more basic needs of life of the poorest man of the State.

Condition of Agriculturist and Agriculture.

Tax on land will fail to achieve the above object. The present condition of the farmer itself bears testimony to this fact. Words cannot depict the real picture of the agriculturist who is undergoing tremendous hardships and who is anyhow prolonging his occupation under adverse circumstances unless one is one with agriculturist and has practical experience of his hard life. It will not be out of place to quote few examples of his grim indebtedness and horrible exploitation due to perpetual financial stress.

(1) Only in Ahmedabad district in 1950-51 the figure of Government tagavi was more than a crore of rupees.

(2) In addition to Government tagavi the co-operative societies of the district also owe 80 lakhs of rupees from the farmers. Over and above large scale private money lending is also going on amongst the farmers.

(3) In one village, out of 97 farmers, 77 are the members of the co-operative society. Average debt of the farmer is Rs. 981. Average debt of Government loan is Rs. 105 and average private debt is Rs. 400. On the whole, the total average debt of the farmer is Rs. 1,486.

(4) Some of the debt of the society and Government is out of date.

(5) Because of the scarcity of rain for the last 3 years, the whole area was famine stricken. There is nothing like saving with the farmer, and as he has surpassed the limits of co-operative, Government and private debt, in most of the cases, he has to dispose of his standing crops at extremely low price. Here we quote a few examples:

Crop	Government or market rate	Disposal Rate of the farmer
(1) Kala (cotton)	Rs. 24 to 26	Rs. 10 to 14
(2) Millet (Bajri)	Rs. 12	Rs. 7 to 8
(3) Paddy	Rs. 18½	Rs. 12 to 14

(B) The farmer has not enough money even for seeds. We quote below few example of what he has to pay for securing seeds.

Kind of Seed	Price per B.M.	Quantity to be paid to exchange	Price per B.M.
Cotton seeds 1 B.M.	14 to 15	Kala 1 to 1½ B.M.	24 to 32
Jowar seeds 1 B.M.	14 to 16	50% of the produce	100 to 125

(C) A farmer took Rs. 200 from a private money-lender. As its interest, the farmer has to pay 50 per cent. of the total produce of a field of 12 acres which gives an income of nearly Rs. 600. That means the farmer pays Rs. 300 as an interest on Rs. 200.

Apparently, one would feel exaggeration in the above examples. But they are facts. All these are private methods of money-lending which the farmer has to resort to. These methods exist to such a large extent that numerous examples of this type of exploitation can be quoted and proved.

The indebtedness of the farmer is beyond imagination and he has to suffer helplessly the terrible exploitation of which the above examples are merely hints. In spite of so many efforts and incurrence of debt neither is he able to get sufficient nutritious food nor is he able to educate his children. He drags his life in tremendous scarcity. Then a question will arise how he pulls on. The fact is that he lives on the indirect exploitation of his cattle, members of the family and labourers who are closely associated with his life and occupation.

6. The farmer has not sufficient means for prospering the agriculture and increase the production and thus he is not able to enjoy proper status in the society and lead a happy family life.

(A) He must have full set of implements for all processes in agriculture, a pair of strong healthy bulls, houses for storing grass and corn, bullock sheds and enough open space. Very few farmers have these facilities while the majority of them are practically devoid of such facilities.

(B) They have not even enough housing accommodation. Most of them have to content themselves with a single room which is also his kitchen and his bullock shed. He has to live in such an unhealthy place unfit for human habitation.

(C) Majority of farmers are not in a position to store grain for food and seeds. He is compelled to sell it off and suffers half starvation.

7. In days of famine, he and the members of his family have to accept hard work of earth-labour on daily wages of only 10 annas. This shows to what an extent his family condition is unstable. He is not able to stand even the effects of one famine.

8. That Government has to resort to confiscation of farmer's property for the recovery of instalments of Government loans shows that the farmer is economically ruined.

9. Government has to give suspensions and at times remission of land revenue.

From the above facts, it is evident that the present taxation of land is even beyond the capacity of the farmer and hence unjust. Under these circumstances, any step to levy more tax on land will do him more injustice.

We agree, in the last 10 years the price of the agricultural produce has gone up. Besides, Government has also enacted certain laws for the economic betterment of the agriculturist and his land such as facilities in building wells, bunds, canals, manure and seeds, Tenancy Act, Debt Relief Act, facilities of finance at low interest through co-operative societies. These steps are no doubt in the interest of agriculture and agriculturist, but they have not benefitted the agriculturists to such an extent that new taxation can be justified.

The price of agriculture produce has increased but by the by, the comparative price of the things consumed by the agriculturist has even gone much more higher.

It is true that in villages few families appear to be happy, but it is mostly due to the extra income they make from sources other than agriculture. There is apparently no remarkable improvement in the condition of 98 per cent. of farmers.

The difference in the past and present economic condition of the farmers should not be the criteria for taxation. But the policy of taxation must be based mostly on the present economic condition of the farmer as the tax payer in comparison with the other classes of society.

In consideration of such condition and circumstances, we are of the opinion that the farmer should not be subjected to any burden of new taxation. On the contrary, we believe that necessary steps should be taken to utilise the major portion of the income from taxation on relief in land revenue and betterment of agriculture.

In spite of the agriculturist being in such condition, we believe that the farmer should also contribute to the national schemes as rest of classes do. So the Government should so formulate their policy of taxation that the income from taxation should be in accordance with the need of the development schemes, and the difference in the capital and income may be eliminated.

Keeping in view the above facts and the conditions in the Bombay state, we have tried to answer the questionnaire.

Agricultural Income-tax.

Question 139.—We consider that instead of land revenue it will be more justifiable to levy income-tax on the income of agriculturist. But this income should be determined after deducting his cost of production, maintenance of his family, etc. In this way, the income liable to be exempted from income-tax should be determined and then on the surplus income only the income-tax should be levied as is done in other cases.

But at the same time, it is quite evident than in the present condition of the farmer, it will be very difficult and nearly impossible to fix the taxable income. The reasons are as follows:—

- (1) Illiteracy of the agriculturist,
- (2) Even the partially literate agriculturist is not accustomed to keep his accounts,
- (3) Dependence of agriculture mainly on the favourable considerations of nature.
4. Looking to the present mentality and other circumstances of the agriculturist exact figures of his income and expenditure cannot be determined and so in absence of authoritative figures there is every likelihood of error in determining his income.

Due to many such reasons, it may not be possible to resort to income-tax instead of land revenue. Still however, income-tax will be more commendable if it can be resorted to in place of land revenue.

In short, we consider it just and equitable if only income-tax is levied in place of the present method of land revenue. But if it is not practicable it will be in no way justifiable to levy income-tax in addition to the land revenue taken at present. So we are clearly of the opinion that—

- (1) Income-tax should not be levied so long as the land revenue scheme is in force in any form,
- (2) Levying of income-tax being more justifiable, we prefer it if the land revenue scheme is done away with.

We suggest this change in the method of taxation not with a view that the revenue of Government may be increased. The main reasons of our suggestions are as follows:—

- (1) Economic condition of the agriculturist be sound,
- (2) Production may be increased,
- (3) Agriculturist and the agriculture both may be able to sustain themselves even in abnormal years,
- (4) And the income of the poorest agriculturist who have taken to this occupation may be increased, resulting in the increase of national income, and thereby in the prosperity of our motherland.

Because of the above reasons, our suggestions are as follows:—

- (1) If Government adopts the policy of levying income-tax, it should immediately take the following steps:—
 - (A) Protection against death of cattle, heavy rainfall, scarcity of rain, famines, frost, locusts and such other catastrophies.
 - (B) Fixation of minimum rates of agriculture produce and if necessary, the preparation of Government to buy the products at these rates.
 - (C) Facility of enough finance for the development of agriculture.
 - (D) Protection against internal and foreign competition.
 - (E) Export and import policy of Government should be in support of agricultural occupation. In spite of it, if the farmer has to suffer the Government should compensate for the proper loss.

If the Government decides to levy income-tax without taking such steps, the result would be that the farmer shall have to pay tax in normal years while he will not get any protection in abnormal years against the loss he has to incur due to natural calamities. Notwithstanding the debt incurred by him due to loss in abnormal years, he shall have to pay tax on the whole income in the normal years. Hence the method of taxation applied to the non-agricultural occupations should not be applied in the case of agricultural occupation, e.g., in case of non-agricultural occupations, the

tax is levied on the yearly taxable income. In case of agriculture this method would prove harmful to agriculture itself and the farmer. So our suggestions are:—

- (1) Income-tax should be levied after taking steps mentioned above in A to E.
- (2) Tax should be taken only if there is any surplus of income after making amends for the loss sustained in the previous year.

Question 140-A.—While considering the method of taxation on agricultural and non-agricultural income, the following fundamental difference should be borne in mind:—

The income in non-agricultural occupation is received mainly from profit, interest and high salaries, while the farmer has to undergo hard labour and natural risks for his income. There is a great possibility of exploitation of other's labour in non-agricultural occupations. Also, they take advantage of the principle of supply and demand, which gives birth to many social evils. As a result the income of this class increases while the farmer has to depend mainly on natural facilities and manual labour. Hence more liberal attitude should be taken in taxing agricultural income as compared with non-agricultural income as compared with non-agricultural one.

In such examples where the main income is obtained from non-agricultural occupation, the income from agriculture should be included in taxable income.

In such examples where the income from the non-agricultural occupations is equal to or more than the amount fixed to be liable for exemption from income-tax, the income from agriculture should also be included in the taxable income.

If the tax is levied on both the agricultural and non-agricultural income the following points will arise:—

- (1) Administrative machinery for assessing and recovering the tax and its expenses,
- (2) The distribution of income between the Central and the State.

The administrative machinery for assessing and recovering the tax must be the same. The agricultural income must go to the State and income from non-agricultural tax must go to the Centre. Expenses of the administration may be divided in proportion to the income.

Question 140-B.—Liberal concessions in land revenue and its recovery should be given to those who, hold less land than land necessary for fulfilling the basic needs of life. Those who mainly depend on income from agriculture should be given this advantage.

We suggest that the following amendments in the present annavari system of land revenue assessment:—

- (1) In every village for every crop 3 fields of best, medium and inferior calibre should be taken and their approximate production should be calculated and their average income should be taken as the income of the running year.
- (2) Income of the good year should be considered as 16 annas.
- (3) The result obtained from comparing the income of the year with the income of 16 annas year should be taken as the anna of that year.
- (4) If any difference of opinion takes place between the village and the assessment officer the final decision should rest with non or semi-official annavari Board which should be appointed on district level for this purpose.
- (5) Annavari should be determined when the crop is standing in the field so that it can be estimated.

Question 141.—In spite of the work of determining the taxable income of agriculture being intricate and difficult, if it is decided to levy income-tax on agriculture then some method of determining it must be evolved.

It can be done in the following way:—

- (1) The villages should be grouped in regional units on agriculture basis, e.g., such agricultural groups of Ahmedabad district may be Bhal, Nalkantha, Kaner, Chunval, Daskroshi, etc.
- (2) In these units, there will be three methods of agriculture production—
 - (a) wet farming, (b) dry farming and (c) mixed farming.
- (3) In every unit the cost of production should be calculated as follows:—
 - (A) The unit of economic holding should be taken as a base.
 - (B) For every crop all expenses on seeds, labour, protection charges, etc., should be taken as basic expenses.
 - (C) Per unit yearly expenses of a pair of bulls.
 - (D) Yearly depreciation of agricultural implements.

- (E) Transportation charges.
(F) Interest on capital.

The total expenditure should be divided by the number of acres per unit and it should be taken as basic expenses for acre.

The expenses should be calculated in relation to the index of price of things necessary for agriculture and cost of labour.

(4) The average production of the last 7 years should be taken as the production per acre, and its price should be calculated, and the total income of the farmer should be calculated according to price index.

Thus whatever surplus remains after deducting the expenses from the income should be taken as net income per acre.

Question 142.—As shown in 140-A, all the members of the farmer's family are helping in farming, the limit of income liable to be exempted from taxation in the case of agriculture should be fixed higher than that in the case of non-agricultural income. In our opinion it should be 25 per cent. more.

Question 143.—Yes. Revision of settlement should be done often.

Question 144.—(1) The limit of revision should be 30 years.

(2) There should be guarantee of every survey No.; as in Bombay State.

(4) Yes.

(A) One who produces more crop per acre should be given concession in land revenue.

(B) Concession in revenue in the cases of food-crop while revenue in the case of money crops should be increased.

(C) One who has improved his land at his own expenses should be given remission in land revenue for certain years, and his revenue should not be increased at the time of new revision.

(5) The revenue of the lands which grow food crops should be taken in the form of corn.

This is possible on the following lines:—

Corn worth the amount of current land revenue should be taken every year and its price should be calculated on the average price of the last 5 years. This method will result in following advantages:—

(1) As the quantity per acre is fixed nobody will be tempted to steal nor he will have to bother about accounts.

(2) As the price of a rupee is fluctuating, the income from revenue will be unstable while value of corn being steady the income in term of corn will be steady.

(3) Even in the present high prices of crops, the farmer has to do his occupation in loss. When the prices of the crops will go down, the value of rupee will naturally increase and under these circumstances, the farmer will find it more profitable to pay land revenue in kind than in rupee.

(4) Government will have certain amount of stock of corn on hand and that will help in partially controlling the market rates.

(5) Apparently, it will mean somewhat less revenue to Government, but if Government pays partial salaries of his servants in kind out of this stock, it will not have to sustain loss in revenue.

(6) It is desirable that every state may have its own policy in accordance with the conditions prevailing in the State.

Question 146.—It will be wrong to interpret the change in circumstances in terms of comprising the prices of agriculture produce. For, just as the prices of agriculture produce have increased, the cost of production has even increased comparatively more. Besides, looking to the present economic poor condition of the peasant and the agriculture, even a temporary effort to increase the old rates in any way or levying of surcharge will be a wrong step. Therefore, we are clearly of the opinion that under no circumstances, there should be any increase in or surcharge on the present land revenue rate. On the contrary, in order to get rid of inequality which exists today, steps should be taken to reduce the high rates.

Question 147.—If the rates in the merged area are higher than the old provinces, they should be reduced so that the inequality may be minimised.

Question 148.—The farmer should not be subjected to even a partial burden of compensation to be paid for abolition of zamindari. For, the steps of abolition of zamindari are taken in the interest of the whole state and every subject of the state gets its advantage. So

the State should pay the compensation out of state income as a whole. It means in introducing Raiyatwari in place of Zamindari. No question of compensation should be brought in. In the same way, the old rates of lease should not be taken into consideration as it in itself was an injustice and to remove which is the duty of the State.

Really speaking rapid steps for settlement should be taken and the *interim* period, rates of taxation should be in accordance with the rates of settlement of neighbouring area or province.

Question 149.—There is little possibility of large-scale co-operative farming in near future, and it is not necessary too. Still however, if it is possible, the introduction of income-tax in place of land revenue will be facilitated.

Question 150.—(3) The following standard should be introduced in place of present standard of suspension and remission:—

(1) The produce per acre of a good year should be considered as 16 annas and in comparison to it any year should be taken as 16 anna year.

(2) In comparison with the 16 anna year—

(A) If the annavari of any year is upto or below 4 annas, Government should give full remission of land revenue that year.

(B) If annavari exceeds 4 annas, but does not exceed 8 annas, half the revenue should be recovered and half should be suspended.

(C) If the annavari exceeds 8 annas but does not exceed 12 annas, the whole revenue may be recovered.

(D) If it exceeds 12 annas and goes upto 16 annas then the whole revenue and half the suspended revenue, if there be, may be recovered.

(E) And if the annavari exceeds 16 annas, the whole current year's revenue as well as the whole suspended revenue may be recovered.

NOTE.—The farmer suffers great loss and has to incur debt in the year when the crop totally fails or is below 4 annas. To suspend the revenue of such an year and to recover it in the next good year is unjust. It should be completely remitted that very year as mentioned in clause (A) above.

Question 152.—No. The village talati enjoys important position and is an important chain in the administrative machinery set up for the collection of land revenue; this machinery is not consistent with the changed conditions after Swaraj, the ambitions of the people and the development schemes. Unnecessary delay and lack of responsibility in work are generally observed on the part of this machinery. It requires a change from its very root.

It cannot be wholly trusted as regards its honesty. In recent years there are numerous examples of their ruining the legitimate rights of the farmers on land in the land record register, as well as misappropriating the money recovered from the farmers as tagavi or revenue.

There should be a machinery of higher authority which is conscious, disciplined and enthusiastic enough to keep proper impressive control over this machinery. But it is not found.

If the village talati is a man of worth and vision, other development works in addition to recovery of land revenue can be exacted from him without prejudicing his efficiency or his work of revenue collection. But this hope cannot be realised from the present machinery of talatis.

Question 153.—It is desirable that the collection of land revenue should be entrusted to local institutions such as village panchayats and co-operative societies. Institutions are found capable of carrying out the work and financial responsibilities of even lakhs of rupees when they get the proper guidance of honest and efficient workers.

In doing so there will be many economical and administrative facilities and at the same time, the progress and efficiency of local institutions will develop.

It will improve the local conditions to a greater extent if the income of land revenue is earmarked for local purposes.

We believe that the greater portion of the land revenue should be entrusted to the local institutions as earmarked. Thus the local institutions will be inspired to take up such administrative activities and the schemes of agricultural development and more production will get impetus. Especially such institutions will get experience of administration as the basic units of freedom, and it will strengthen the root of their national spirit.

Question 154.—For the purpose of enhancing the income, no cess in addition to land revenue should be levied.

(1) & (2) In Bombay State, per rupee of land revenue local cess of one anna, two annas, and lately three annas are being taken. Cess of this type is necessary.

(3) (A) The income of such local cess is completely entrusted to the District Local Boards in the Bombay State. The whole income of such cess should be given to such local institutions as is done in Bombay State.

(B) Yes. This amount should be spent for the local benefit of village taxpayer. In Bombay State this type of income is earmarked and is used for wells, roads, schools, inns, dispensaries, improvement in agriculture, etc.

Irrigation, Rates and Betterment levy.

Question 155.—(1) No.

(2) Yes.

(3) No.

Question 156.—We have given our opinion on taxation for supply of water by irrigation scheme in 155(2). We do not favour additional land betterment tax, because the increase in production will be due to the supply of enough water at the right time. But it does not in any way improve the texture of land. On the contrary, in some cases the fertility of land decreases and the agriculturist has to undergo additional expenses

for giving manure to the land. So the betterment tax should not be levied.

Question 157.—The tax should be levied in exact proportion to the actual supply of water. The tax in the case of major irrigation schemes should be so levied that the interest on the capital invested and certain portion of invested capital may be recovered in certain years. Whatever surplus income is obtained from this taxation after deducting the running expenditure should be utilised for irrigation schemes and betterment of agriculture. The tax should be reduced after the amount invested in the scheme is fully recovered.

(2) The actual supply of water and the yield of crop should be taken into consideration.

(3) Revision should take place at intervals. At the most of the limit of revision period should be 7 years.

(4) Yes. In order to improve the agriculture and to encourage special crops, concessional rates should be fixed in the primary stage of development.

Question 159.—We do not favour compulsory irrigation cess because while calculating the tax the running of expenditure of the scheme must have been taken into consideration.

Question 160.—We do not favour consolidated rate under any circumstances.

Question 161.—As shown in 157(1) it will be possible to finance local schemes out of the surplus income from the irrigation tax.

We are not in favour of surcharge on irrigation rates.

The Bombay Co-operative Banks' Association.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

This Bombay State Co-operative Banks' Association was established in the year 1939 as an association of co-operative banks of the State of Bombay. All central co-operative financing agencies, whether known as Apex Bank, Central Banks or otherwise, are eligible for membership and are members of the Association. Similarly, all non-agricultural urban co-operative banks with a paid-up share capital of Rs. 20,000 and above and carrying on as their principal business the acceptance of deposits on current account subject to withdrawal by cheques, drafts or order are eligible for its membership. At present, all the 29 Central co-operative financing agencies including the Apex Co-operative Bank and 88 Urban co-operative banks are members.

As an association of Co-operative Banks, we shall deal with only those questions of the Taxation Enquiry Commission which have a direct bearing on income of co-operative societies.

Although the co-operative movement in India is now in existence for over 50 years, all the various institutions registered under the Act are not equally old nor equally strong. In fact, the movement can be said to have started to make good progress only since the advent of the National Government in 1947. There are many States like Bihar, Orissa, Assam, Bengal and the Punjab where most of the credit institutions are in the process of reconstruction and have to depend on direct State aid for their existence. In the new States of Vindhya Pradesh, Himachal Pradesh, Rajasthan and Saurashtra, the co-operative credit institutions have still to gather momentum. Even in States of Bombay and Madras where co-operative credit institutions have been developed fairly well, they depend a good deal on concessional funds from the Reserve Bank and direct and indirect State assistance. There is therefore a clear case for the continuation of all the tax concessions to the co-operative movement, as the co-operative form of organisation has been assigned an important part in the development of the country, and should therefore receive every possible encouragement.

PART II—DIRECT TAXATION.

INCOME-TAX.

Question 57 (i).—Should the business profits of co-operative enterprises which are now exempt, be charged income-tax and super-tax?

If so, should co-operative societies be treated as companies or should a lighter tax be imposed?

In case the exemption is continued, should it be restricted to certain categories of co-operative enterprises?

Present Position.

On 26th August 1925, the Government of India under Finance Department (C.R.) Notification No. REIS-291-IT/25 dated 25th August, 1925 exempted "profits" of co-operative societies registered under the Co-operative Societies Act, 1912 or dividends or other payments received by members from any society from income-tax.

This exemption to co-operative societies was given on the lines of mutual benefit societies of Great Britain. The members of a co-operative society form part of the corporate whole, namely, a society, and as a person cannot be said to have made a "profit" or "income" out of himself, the income derived by societies from members was deemed as non-taxable under the Income Tax Act. The "income" from members of a co-operative society merely represents transfer of money from one pocket to another and after appropriation of a part of the income towards administrative expenses, the rest is utilised in building up reserves, strengthen its financial position to the benefit of the members or is returned to members in the shape of dividend on shares or rebate in interest charged on loans or goods sold to members.

The Notification of 1925 exempted all profits of a co-operative society from whatever source derived. With the increase in investments of societies in gilt-edged securities and consequent deduction at source of income-tax from interest paid by Government, the question arose as to whether this income from interest on securities was also exempt under the Notification. Accordingly, amendments in the Notification were made with a view to make the position clear and an explanation to the notification was added. The Explanation to the Notification as finally emerged after considerable experience was gained, was issued on 18th August 1945 which continued the exemption given to co-operative profits of societies under Section 8 of the Income Tax Act and also mentioned the sources from which any income if derived was taxable. The Explanation runs as follows:—

"For this purpose, the profits of a co-operative society shall not be deemed to include any income, profits or gains from (1) investments in (a) securities of the nature referred in Section 8 of the Indian Income-tax Act or (b) property of the nature referred in Section 9 of the Act; (2) dividends; (3) or the other sources referred in Section 12 of the Indian Income Tax Act."

Under the above amended Notification, the present position is as follows:—

(a) A co-operative society is taxed as an association of individuals while a banking company is taxed as a company.

(b) A co-operative society being an association of individuals is liable to be taxed at a graduated scale of income-tax applicable to an association of individuals and a surcharge of 5 per cent., with a flat rate of super-tax at the rate of annas 2/6 and surcharge of 3 ples making 2 annas 9 ples in a rupee after the initial exemption of Rs. 25,000. A banking company being a company registered under the Companies Act is liable to be taxed at the maximum rate of income-tax, viz., annas 4 in a rupee plus 5 per cent. surcharge and a

flat rate of super-tax at annas 2/9 in a rupee on the whole of its income without any statutory exemption both for income-tax and super-tax.

- (c) A co-operative society's profit below, Rs. 4,200 is exempted. A banking company has no minimum exemption limit.
- (d) A co-operative society's profit from co-operative business is wholly exempted under the above Notification. The only income of a co-operative society liable to tax is income from sources mentioned in the explanation to the notification, i.e., income liable to tax under Sections 8, 9 and 12 of the Indian Income Tax Act. A banking company's profits are liable to be taxed under the heads of income under Section 6.
- (e) The total income for income-tax purposes of a co-operative society includes the exempted income from co-operative business not liable to income-tax and super-tax. The total income of a banking company includes income from all sources liable to tax under Section 6 of the Income-tax Act. Thus, the total income and taxable income in a banking company are more or less synonymous while in the case of a co-operative bank this is not so.
- (f) Expenses of administration are not allowed to be deducted in a co-operative society from non-co-operative income; but the entire administration expenditure is made chargeable to income from co-operative business profits.
- (g) A co-operative society's dividend is not required to be grossed up for rate purpose nor is it subject to tax as it is exempted from income-tax under the notification.
- (h) A co-operative society's debentures are not treated as securities under Section 8 of the Income-tax Act with the result that no income-tax is deducted at the source while paying interest on them. The individual holder, however, is liable to pay. There is therefore no loss to the State but only convenience to small holders. A banking company, however, is bound to deduct income-tax on interest paid on debentures. A co-operative society being an association of individuals is neither a "local authority" nor a "company" under Section 8 of the Income-tax Act and is not, therefore, liable to deduct income-tax from interest paid on its debentures.

Exemption from income-tax to co-operative business profits of societies has been granted, as is clear from the above, on the principle that the object of a co-operative society being mutual benefit it cannot be deemed to have made any profit out of itself. The entire administration cost of co-operative societies is debited to income derived from co-operative profits for income-tax purposes and income-tax levied on the other profits without any deduction being allowed for administrative expenses. On an average between 30 and 40 per cent. of the working capital of a co-operative bank remains invested in gilt-edged securities for fluid resource purposes under the Co-operative Societies Act and Rules, the income from which is liable to tax. Therefore, interest earned on securities held by co-operative banks should also be exempt from tax.

The levy of income-tax on co-operative profits will mainly have the effect of taxing the co-operative financing institution. The co-operative financing structure, as prescribed by the MacLagan Committee, provides for an apex credit institution at the top with the central financing agency as an intermediary usually at the district level and the village primary agricultural society at the base. If income-tax is levied on co-operative profits and societies treated as companies for taxation purposes, it will have the effect of income-tax being charged and collected at all three stages. This will mean a triple levy of tax on the same funds and must result in a substantial increase in the lending rate to the ultimate agricultural borrower, who is required to be provided cheaper finance than has been possible at present as recommended by the Planning Commission. The Royal Agricultural Commission and the Gadgil Committee suggest that the rate should not be higher than 6 per cent. per annum. If the lending rate is to be kept down even at the present level of 7-13/16 per cent., the State will have to give additional assistance to co-operative credit institutions. The levy of income-tax on co-operative profits of societies will therefore mean indirectly taxing of the State revenues. Even in co-operatively well-advanced States like Bombay and Madras, the rate of advance to the ultimate borrower is nearly 8 per cent. per annum while in other States

the rate of advance to the ultimate agriculturist borrower varies from 8 per cent. to 12 per cent. per annum. The Zamindari, Talukdari and Inamdari systems are all being abolished in the country and radical reforms in land tenancies are taking place in all the States of the Union. Vast irrigation schemes are being undertaken at huge cost to Governments to step up agricultural production. At the present stage, therefore, we do not think it would be in interest of agricultural production to levy income-tax on co-operative profits of agricultural co-operative credit institutions.

The next likely objective of the proposed levy of income-tax on co-operative profits will be the Urban co-operative bank. Urban co-operative banking has not developed in any other State to the same extent as in the State of Bombay. The object of Urban co-operative banking is to supply the needs of petty traders and artisans, many of whom individually have an annual income of less than Rs. 4,200 which is the minimum chargeable to income-tax. Urban co-operative banks are subject to the same regulations regarding dividend, allocation to reserves, rebate in interest charged, etc., as agricultural co-operative credit institutions. They are also assisted in their day-to-day administration by non-official sympathisers who make no charge for their service. In spite of these advantages, most of these banks are not able to reduce their lending rate in the State of Bombay below the maximum prescribed under the Bombay Money-lenders' Act. Unlike agricultural co-operative credit institutions, Urban co-operative banks get no assistance at a concession rate from the Reserve Bank of India and no assistance from the State either. They have to discharge their duties in competition with big commercial banking institutions. Without such banks, the petty traders and artisans may find it difficult to raise funds for their business activities. Due, however, to the smallness of their individual resources and the small average loan combined with the necessity of constant supervision over members, their administration cost compared to working capital is higher than that of big commercial banking institutions. Levy of income-tax on their co-operative profits will, therefore, mean a material addition to the cost of funds to petty traders and artisans who would individually not be subject to income tax under the minimum income clause of Rs. 4,200.

The next objective of the proposal to levy tax on co-operative profits of societies is perhaps the purchase and sale union. Many co-operative purchase and sale societies have come into being since the advent of the National Government primarily because the function of distribution of controlled commodities was entrusted preferably to such institutions. Various concessions were given by Government to co-operative distributive agencies and they were encouraged to undertake this work in order to ensure a fair and equitable distribution of controlled commodities. Many new co-operative distributing institutions, therefore, came into being and did substantial wholesale and retail distribution of controlled articles. Their income during the period of controls was fairly substantial, but only that portion of their income which was derived from co-operative business, was not subject to income-tax. The income derived by them from articles sold to non-members was subject to income-tax. With the removal of Government controls on cloth, iron, steel, cement and many other commodities, several co-operative purchase and sale societies have since come to grief. There are others which have suffered severe losses due to the accumulation of stocks they had to lift under Government orders although the goods could not be sold for local consumption. Especially in the State of Bombay, the condition of many such co-operative purchase and sale societies at present is such as not to encourage the hope of any substantial gain by the levy of income-tax on their co-operative profits also.

To sum up, it will not be desirable in our view to levy income-tax, surcharge and super-tax on co-operative profits of societies, because—

- (1) A co-operative society is a mutual benefit society without any profit motive and the income derived from its members is not really an income but transfer of funds from one pocket to another of the institution;
- (2) Co-operative institutions are in different stages of development in different States of the country. In Bihar, Orissa, Assam, Bengal and the Punjab, co-operatives are in the process of reconstruction and depend on direct States aid. In Vindhya Pradesh, Himachal Pradesh, Rajasthan and Saurashtra, the movement has still to gather momentum.
- (3) Although the co-operative movement was introduced over 50 years ago, all the institutions registered under the Co-operative Societies Act are not old and developed equally. In fact, the development of co-operative institu-

tions is of recent growth, i.e., since the advent of the National Government.

- (4) The rate of interest charged to the ultimate borrower in agricultural co-operative societies, in spite of their economic management and availability of free honorary service, substantiating it from the State and availability of funds at $1\frac{1}{2}$ per cent. from the Reserve Bank of India, is still very high.
- (5) Many of the purchase and sale societies which owed their origin primarily to direct State aid and Government controls on distribution have now come to grief with the removal of controls.
- (6) Co-operative dividend is limited by statute to the maximum amount of $6\frac{1}{2}$ per cent. including bonus on share capital subscribed.
- (7) Co-operative reserves are used as mentioned below for activities of a beneficial nature, and do not belong to the members or shareholders on liquidation:
 - (a) An object of public utility of local community interest;
 - (b) A charitable purpose as defined in Section 2 of the Charitable Endowments Act 1890; or be paid to
 - (c) The Bombay Central Co-operative Institute and placed as reserve of a new society registered in the place with the consent of the Registrar.

We do not also consider it would be advisable to treat co-operative societies as companies for income-tax purposes, as that will enhance the rate of income-tax payable by co-operative societies. In Companies, there is also no "minimum" taxable limit of Rs. 4,200 as in the case of associations of individuals. This must mean that all registered societies would be liable to income-tax whatever be the amount of their annual income. In the State of Bombay alone, there are nearly 18,000 societies, out of which 9,000 are primary agricultural societies. Most of these primary societies are unable to engage trained staff even to write their ordinary accounts. Annual submission of income-tax returns for most of them must present insurmountable difficulties. All their members are drawn from poor classes who are individually not subject to income-tax. Apart from these considerations, even from the point of view of income alone, the cost of levy and recovery of income-tax, if all societies are treated as companies, will not, in our view, be less than the amount of tax realised from them while most of the societies will find it difficult to meet the cost of staff necessary for the purposes of the tax levy. The honorary office-bearers under the circumstances will find it easier to avoid acceptance of their onerous office rather than be answerable for irregularities, to income-tax authorities.

We are also not in favour of restricting the exemption from Income-tax only to certain categories of co-operative societies, because the "profits" derived by co-operative societies from members do not really represent any income but merely a temporary transfer of fund from one pocket to another of the corporate body, as their object is not to make profit but render service to members and return the excess charge for service if any, made by them to their members.

Question 57 (ii).—Do you agree with the view that the income derived by co-operative housing societies by way of rent should not be treated as income from property assessable to income-tax? Would you in this respect differentiate between tenant co-partnership housing societies and other types of housing societies?

The Exemption Notification mentioned above exempts "profits" of co-operative societies or their gains from business, profession or vocation. This exemption applies to profits or gains from members in a co-operative society which is considered its legitimate business, profession or vocation. Its "profit" or gain from other sources is liable to income-tax. The chief reason for the exemption was that a co-operative society was a mutual benefit association without any "profit" motive in its business relations with members.

The Exemption Notification of 1925 related mainly to co-operative banks or co-operative resource societies as these were then the principal societies with sufficient income liable to income-tax. In the "Explanation" subsequently added to the Notification, the income of a co-operative society from gilt-edged securities, house property and sources other than co-operative was made liable to tax for the reason that building houses and deriving income from them was not an income from the legitimate business of a co-operative resource society. Taxation of the property income of a resource society was therefore equitable. In the case of a co-operative housing society whose chief business is to provide suitable residential accommodation to members, the case, however, is entirely different. The benefit con-

ferred by a co-operative housing society on its members is the provision of suitable house accommodation and therefore, in our view, it is income, gain or profit from its legitimate business and should be exempted from income-tax.

In the State of Bombay, there are two main types of co-operative housing societies, viz., the tenant ownership and the tenant co-partnership co-operative housing society. The function of the tenant ownership housing society is to purchase a suitable building site, develop it by providing roads, drainage, water, lighting, etc., divide it into suitable size plots and allot these to members on recovery of the amount of cost. This includes the cost of development. Each member is required to submit a plan of his building for approval to the society and the society sometimes arranges for the contractors if required, examines and approves estimates of cost and provides loans with suitable margins both for the plot of land and the building if required. These loans are recovered with interest in convenient instalments. The plots, although paid for, are the property of the society and are leased to members on nominal fee. The member thus becomes a tenant of the land. The building on the land is owned by the member and municipal, property and other taxes are paid directly by the member. Income-tax on rental value, if his income exceeds the minimum, is also paid by the member. In such tenant ownership societies, it would, we presume, be legitimate to levy income-tax on individual owners of the houses, provided the taxable income of the individual member including the valuation of his building is above the minimum prescribed under the Income Tax Act. The income of tenant ownership societies should not, in our view, be taxed as it is a charge levied for the upkeep and maintenance of roads or sanitation or water supply or to meet administration expenses or the cost of upkeep of the common property for the benefit of the members. These charges are levied for the mutual benefit of tenant members and is not a charge with a view to make profit. In the State of Bombay, there is a further rule in tenant ownership societies that in case a member is required to sell his building (which is done with the previous consent of the society) at a profit, the profit after allowance is made for the cost and interest, etc., at a stipulated rate is shared between the society and the member. This is an item of income of the society which requires separate consideration for income-tax purposes. So far as we are aware, such sales are few and far between compared to the number of members provided with houses by tenant ownership societies. We believe, therefore, that income-tax would be a proper levy on individual owners on the municipal rental value of their houses as well as on dividend if any, received by them from the society, provided their income is above the minimum exempted under the Income Tax Act. The income from members of tenant ownership housing societies should, however, be exempted from income-tax.

The case of tenant co-partnership societies is different from the point of view of income-tax. In tenant co-partnership societies, land as well as the houses are shown as the property of the society in its books; each member being required to pay a fixed percentage of the cost of construction of his flat or tenement and the balance of the cost being met by the society by raising a loan either from Government or from another society or an insurance company. The amount paid towards cost in lump as well as monthly instalment by a member is his contribution to the share capital of the society. Each member in such societies is allotted a suitable flat or tenement with the right of transfer by sale or inheritance with the consent of the society. All taxes on the property are paid by the society such as lease rent, ground rent, municipal property water and other taxes. The member contributes to the society by monthly instalment towards the cost of his flat including interest on the loan borrowed, his contribution towards principal cost being a further contribution to the share capital of the society. In addition, the monthly contribution includes the establishment cost of the society, cost of repairs, painting and whitewashing of the property periodically undertaken by the society to keep them in fit condition. For want of a better name, this monthly contribution levied by the society on each tenant is called "rent", although it is not really monthly "rent" that the society charges, the portion towards principal amount being appropriated to share capital while interest on loan borrowed and other expenses recovered being credited to the accounts in the society and paid or spent when required. For income-tax purpose, this so-called income is treated as the income from "property" of the society and taxed to Income Tax. The "rent" income in such a society is not really its income from building property but a monthly collection made from members who have limited means, for the sake of their convenience, for loan instalment, interest, municipal and other taxes, lease and other land rent if any, repairs and renewal of

the property and administration cost of the society. As was observed by Their Lordships in the cases referred to the Madras and Rangoon High Courts, "members of tenant co-partnership societies occupy their holdings as tenants and pay the prescribed 'rents' which constitute the income or profits of a society. It is a case of profits being made out of themselves and it could never have been the intention of the framers of the Notification to tax such societies". The distinction between a tenant co-partnership co-operative housing society and a co-operative bank or resource society holding house property is clear and definite. But when the "Explanation" to the Exemption Notification was drafted, the framers had in view only co-operative banks and other big resource societies and income from "property" was made liable to income-tax by the addition of the explanation.

The so-called "income" from house property of tenant ownership societies should not, therefore, be liable to income-tax as such a society cannot make any income out of itself, its members constituting the corporate body. The property held by tenant co-partnership housing societies should, therefore, be exempted from income-tax by providing an 'exemption' to the "Explanation" to the Exemption Notification.

Question 57 (iii).—It has been suggested that there are divergent decisions by different income-tax authorities in respect of assessment of income of co-operative societies from sources other than business. If this is so, please indicate such decisions and the measures you would suggest to secure uniformity in assessment.

In June 1949, a deputation on behalf of the Bombay Provincial Co-operative Institute and the Bombay Co-operative Banks' Association waited on the then Member of the Central Board of Revenue, Shri K. Govindan Nair, at Bombay. In its minutes of discussion dated 14th June 1949, it mentioned the variations in the method of assessment of different co-operative banks by income-tax authorities in different parts of the State of Bombay. This minutes of discussion with him together with a list of difference in the assessment of at least six district central co-operative banks situated in different districts of Bombay are enclosed herewith for perusal. (Appendix A).

The position in this respect has not materially changed since the year 1949. Some of the important divergences in decisions regarding co-operative banks during recent years are given below. A copy of a letter received from an Income-tax Officer by the Apex Bank in Bombay is also enclosed (Appendix B) to show that interpretations by Income-tax authorities of the Exemption Notification of the Government of India continue to differ from day to day even to this day.

In the Bombay State Co-operative Bank, deduction allowed for establishment cost for its portfolio of securities constitutes less than 1/300th per cent. of its total establishment cost which is approximately Rs. 17 lacs per annum, while its total investment in securities constitutes 1/3rd of its total working capital. In other co-operative banks of the State, no deduction or only nominal deduction is allowed for establishment cost out of the taxable income from their investment portfolio which constitutes 33 per cent. to 50 per cent. of their total working funds. The entire cost of administration is debited to income from co-operative business only for the purpose of income-tax. Thus the non-co-operative income is increased and is charged to income-tax, surcharge and super-tax. As maintenance of adequate fluid resources against deposit and other liabilities in gilt-edged securities is an obligation imposed by the Co-operative Societies Act and as the yield on such securities is admittedly lower as compared to all other advances and investments, the practice of not allowing deduction for administration cost proportionate to the average amount invested in gilt-edged securities imposes a heavy tax burden on co-operative banks at two stages, viz., the Apex as well as the District Co-operative Bank. This practice, thus, is instrumental in enhancing the lending rate to the ultimate borrower. This, therefore, requires an early remedy. In fact, investment in Government securities to maintain fluid resource is intended for meeting deposit liabilities and is an integral function of co-operative banking. The interest paid on deposits is permitted to be deducted from interest received on fluid resource investments in gilt-edged securities. Similarly, the proportionate cost of establishment for proportionate deposits invested in gilt-edged, being an addition to the cost of these borrowed funds, should be allowed to be a charge on the interest earned in gilt-edged investments.

In addition, there are other variations in assessment. For instance, there is no uniform method of computing borrowed and invested capital in co-operative banks. Correct appraisal of interest paid on borrowed funds is necessary as deduction from interest earned in gilt-edged securities which are chargeable to tax, is allowed under Section 8 of the Act. Some In-

come-tax authorities take the average of the owned and borrowed funds at the beginning and the end of the year of assessment, while some take figures of each month and average these and others take the figures of the date of closing of the year for the purpose of calculating the interest paid per cent. of borrowed fund. The correct method in our view would be to take month-end figures and average these by 1/12th to ascertain the exact amount both of interest paid on deposits and earned on investments.

In case part of its building is occupied by a co-operative society for its own business, it should be exempted although this constitutes "property income" as a building is necessary for all banking and other business, whether co-operative or otherwise. The practice in this respect is not uniform.

Interest on overdue principal is taken into account in determining the total income for tax purposes although the Co-operative Societies Act and the Rules prohibit the calculation of such interest as income. The practice in this respect is also not uniform.

The accounts of co-operative societies are audited by Government Auditors or Auditors approved by the Registrar of Co-operative Societies. Co-operative societies have no 'profit' motive and are democratic institutions in whose management a good deal is contributed by workers in honorary capacity. Most of the co-operative institutions, besides, have their offices in mofussil towns where no expert advice in income-tax matters is available. A simple and uniform method of their assessment can, therefore, be introduced without any danger of its being abused. This can be done by laying down definite rules and prescribing separate forms for submission of income-tax returns by co-operatives. Clear instructions to Income-tax officers with regard to tax-free and taxable income for different types of societies would also be necessary.

PART V. STAMP DUTIES AND COURT FEES.

Question 162.—Under the Constitution (1) The Union is empowered to fix the rates of stamp duties in respect of bills of exchange, cheques, promissory notes, bills of lading, letter of credit, policies of insurance, transfer of shares debentures, proxies and receipts and (2) the States are empowered to fix the rates of all other stamp duties.

As regards (1) and (2) have you any suggestions to make for the levy of a stamp duty where it is not already levied or for an increase or decrease of the present rates where a stamp duty already exists? Please give reasons for your suggestions. Are there any general principles which you would propose for adoption in regard to the fixation of rates of stamp duties?

As regards (2) since the rates vary from State to State, what degree of uniformity do you consider desirable and feasible and how do you propose to achieve it?

If possible, please estimate the net effect of your proposals on the revenues of the States.

The Government of India Notification No. 2781-F, dated the 23rd October 1919 (Finance Department—Separate Revenue Stamp) of the Governor-General-in-Council under Section 28 of the Co-operative Societies Act 1912 (II of 1912) remitted the Stamp Duty with which under any law for the time being in force, instruments executed by or on behalf of any society for the time being registered or deemed to be registered under that Act, or instruments executed by any officer or member of any such society and relating to the business of the society (other than cheques of individual members drawn against their current accounts with co-operative banks) are chargeable under the Indian Stamp Act 1899. Subsequent to the date of the Notification, stamp duty on 'receipts' became a Provincial subject and all Provincial Governments exempted co-operative societies from stamp duty on receipts issued by them or by their members. Under the new Constitution of the Union Government, stamp duty on 'receipts' is now a subject for the Union Government. As Notification No. 2781-F, dated the 23rd October 1919 is still in force, co-operative societies are exempted from stamp duty on bills of exchange, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies as well as receipts.

The exemption was granted in the year 1919 with a view to encourage the formation of co-operative societies. The necessity for continuing this exemption is greater now as the accepted policy of the present Government is to encourage co-operative effort. With a view to establish a "Co-operative Commonwealth", co-operative effort needs the encouragement. In many States, the movement, after the last economic depression and the separation of the two countries, is being reconstructed with State aid. In many other new States, the movement has only recently been introduced. In the very few States which are co-operatively developed now, good progress has been registered mainly after the advent of the National Government in 1946-47. In

no States is the movement so far entirely free of Government aid in men as well as money.

Co-operative institutions have to deal mainly with poor classes. The number of their transactions are very large as compared to amount unlike commercial institutions in which the number of transactions is proportionately small compared to amount. If stamp duty is levied on the documents of societies enumerated in Question 162(1), it will mean a substantial addition to their cost of management and must retard their further development. Most of the co-operative institutions are not able to engage trained staff due to insufficient income. Imposition of stamp duty will further mean a tax on members most of whom are admittedly not able to pay additional taxes. A sound system of taxation in a country presupposes an equitable distribution of the burden of taxes according to the capacity of the different classes of people to pay. Viewed from this point of view, stamp duty on documents of societies will not be an equitable charge as it will be an additional burden on those who are least able to pay. We recommend, therefore, that exemption from stamp duty on documents of societies mentioned in Question 162(1) granted under Notification No. 2781-F, dated the 23rd October 1919 be continued for some time to come.

The exemption notification does not apply to stamp duty on cheques drawn on current accounts by depositors in banks as at the time it was issued, cheques were liable to stamp duty of anna one per cheque. Subsequently, with a view to develop Indian Banking and to encourage banking habit in the people, Sir Basil Blackett, Finance Member of the Government of India, after the first World War, remitted stamp duty on cheques and sacrificed an annual estimated revenue of over Rs. 70 lacs to the Government of India. The extent to which this action was instrumental in developing banking habit among the people and attract the proverbially shy Indian capital into Banks can be gauged by the aggregate amount of deposits, the number of offices and branches and the resources of Indian Banks as well as other Banks in the country before and after this remission. The aggregate amount of the Public Debt of the country before and after the remission and the proportion of the Public Debt raised in India and abroad since the First World War provides another proof of the wisdom of this step in extending banking habit in the people and encourage Indian capital to discard its proverbial shyness.

The necessity of pooling the savings of rural areas to make them available for increasing production and employment in the country became urgent after the devaluation of the Rupee in 1949. The Rural Banking Enquiry Committee was accordingly appointed by the Government of India to suggest ways to collect rural savings by extending banking facilities to rural areas. To facilitate the extension of banking facilities to rural areas, Government were inclined to give even subsidies and to entrust the cash work of Government Treasuries and Sub-treasuries to banks approved for the purpose. The Rural Banking Enquiry Committee made several recommendations with this object in view for assistance from the State and the Reserve Bank of India, most of which have since been adopted. Remittance charges of the Reserve Bank of India and its Agent the Imperial Bank of India of funds between treasury centres for banks, etc., have been reduced by half and encouragement is being given for extending banking habits in rural areas by Government Post Offices, Treasuries and Sub-treasuries. Additional subsidised branches of the Imperial Bank and Co-operative Banks are also encouraged. At this stage of banking development, a re-introduction of the stamp duty on cheques will obviously retard this growth and must adversely affect the husbanding of rural savings and their use for schemes of public utility.

So far as co-operative banks are concerned, the effect of the re-imposition of stamp duty on cheques must seriously affect their growth and expansion in rural areas as the average amount of a co-operative bank cheque is small as they deal with people of limited means whose savings are small. The importance of co-operative banks in the provision of banking facilities in rural areas is recognised by the Rural Banking Enquiry Committee and is borne out by the Statistical Tables relating to Banks in India for the year 1952 published by the Reserve Bank of India. From the information regarding the number of offices of banks with paid-up capital and reserves of Rs. 50,000 and over published in Appendix I to this Statement, it appears that in the State of Bombay there are 313 centres which possess either offices of commercial or co-operative banks with paid-up share capital and reserves of Rs. 50,000 and over. Out of 313 centres, 105 centres according to this had offices only of commercial banks while 153 centres had offices only of co-operative banks. This indicates that nearly half the total number of centres in rural areas possessing banking facilities were so served only by co-operative banks. The concentration of offices of commercial banks

is naturally in centres of trade and industry whose number is limited while co-operative banks are distributed in rural areas providing banking facilities in centres where commercial banks cannot obviously have self-supporting offices. If Stamp Duty is relieved on cheques, the business of these mofussil co-operative banks which are providing banking facilities and encouraging thrift in rural areas must be seriously affected. We, therefore, suggest that no Stamp Duty be levied on cheques at present.

With regard to variations in the rates of stamp duty on other documents, which is one of the State subjects under the present Constitution of the country, these are, in our view, necessitated by exigencies of local conditions and financial needs of the States concerned. Complete uniformity in rates of stamp duty on various documents in different States will be difficult of achievement at once, although it is very desirable that the rates of duty for similar documents should be uniform throughout the country. To achieve this object, as a first step, we suggest that stamp duty levied on various documents by State Governments should be analysed and the analysed statements be sent to each of the State Government with recommendation of the Union Government to amend or modify their duty rates to fall in line with the rates prevalent in a majority of the States. We suggest merely a recommendation and not a directive in this matter from the Union Government in the initial stages.

The Government of Bombay in their Notification Nos. 3648/45 and 3648/45(a) of 26th July 1948 revised the exemption limits for Co-operative Societies of the State of Bombay of Rs. 2,000 and Rs. 10,000 and in doing so, a distinction was made between transactions of Urban Co-operative Banks and Central Co-operative Banks. The original exemption from stamp duty to documents of Rs. 2,000 and Rs. 10,000 was prescribed when prices were low. There has been a substantial increase in prices after the 2nd World War. We suggest, therefore, that exemption limits for Co-operative documents be raised to Rs. 5,000 and Rs. 20,000 irrespective of whether the documents relate to transactions of Urban co-operative banks or of Central co-operative banks.

APPENDIX A.

Minutes of the discussion which the member of the Central Board of Revenue, Mr. Govindan Nair had with the deputation of the Co-operative Banks and Societies on 14th June, 1949.

The deputation consisted of Mr. V. P. Varde, Hon. Secretary of the Institute and Managing Director of the Provincial Bank, Mr. R. K. Dalal of Messrs. Dalal & Shah, Income-tax Experts, and Mr. V. M. Thakore, the Manager of the Bombay Provincial Co-operative Bank. The deputation submitted a written Memorandum.

Mr. R. K. Dalal, on behalf of the deputation, explained the various points arising therefrom. The following points were discussed:

1. Debenture Interest.

It was pointed out to the Member that of late the Income-tax Officer dealing with the assessment of the Co-operative Society has required them to deduct income-tax on interest paid to the debenture issued by such Society or Bank on the ground that under Section 8 such debentures are regarded as securities and under section 18(3) the person responsible for paying such interest, i.e., bank is bound to deduct income-tax at source. It was pointed out to the member that the above view of the Income-tax Officer is entirely misconceived in law since under Section 8 what is regarded as security is "DEBENTURE ISSUED ON BEHALF OF THE COMPANY". Under Section 2(6) a Company has been defined as Company defined under the Indian Companies Act. A Co-operative Society or a Bank is not registered under the Companies Act, although it is styled sometimes as Company, but under the Co-operative Societies Act. A Society's liability unlike that of a Company is sometimes limited and sometimes unlimited. Hence it follows that Societies were not Companies, *a fortiori* the debentures issued by it were not debentures issued by a Company within the meaning of Section 8.

The Member was good enough to look through the Note and found that there was much truth in the grievance made by the deputation in their memorandum and observed that he would after further consideration issue necessary instructions to the Commissioner about the same.

2. Investment securities held by the Provincial Bank.

The next question raised was in relation to levying the assessment on Provincial Co-operative Banks as regards Government securities held by them. Having regard to the *modus operandi* as well as the restric-

tions placed on it under the Act, as regards investments, the profit and loss thereon was regarded as capital gains or loss and as such it was not within the purview of the Income-tax Act to subject it to tax. The purchase and sale of investments, it was pointed out, was made not with the idea of making a profit by dealing in investments, but incidental to carrying on other co-operative banking activities, viz., Government securities. The idea behind buying and selling of investments, it was emphasised, was not trading as in case of other commercial banks. Under Section 37 of the Co-operative Societies Act, it was pointed out, the co-operative banks were required to INVEST surplus funds only in trustee securities or in deposits with the Commercial Banks approved by the Registrar. This clearly shows that restrictions were placed upon the investments of Co-operative Banks so that they may not carry on any trade or business in investments. The profits of a Co-operative Society are exempt under Section 60. Therefore, even if such profits are made taxable they do not affect the assessment except so far as the determination of the appropriate rate is concerned. It was earnestly submitted to the Member that the Board would sympathetically consider these submissions and issue the necessary instructions in order to mitigate the incidence of tax due to the inclusion of such profits on sale of securities in the total income of such banks.

The Member did not seem inclined to the view that such profits should not be included in the total income of the Bank for rate purposes. He, however, promised to give further consideration to this matter after he had returned to the headquarters.

3. Method of determining profit or loss on securities.

While the deputation was on this issue, it pointed out the difficulty of determining the profit on sale of such securities by reason of the practice followed by the Bank, with the approval of the Registrar of Co-operative Societies, viz., crediting sale proceeds and debiting the purchase price to the Investment Block without adjusting the profit or loss thereon to the Profit and Loss account. This practice has been going on for years and it was now next to impossible to determine the profits on sale of securities with any degree of exactness, in the absence of the true purchase price of securities. The deputation, therefore, pointed out that if these profits are to be added for rate purpose at least instructions should be issued that where the cost cannot be ascertained either of the following two methods should be adopted:—

(1) The principle of last-in-first-out should be consistently adopted each year for ascertaining profit.

(2) The profit on securities should be determined by applying to the opening and the closing stock of investment the market value at the beginning and the end of the year. This method when practised takes into account market fluctuations.

It was urged that either of the two methods consistently followed each year after acceptance should not be objected to by the Department. The Member agreed after further consideration to issue necessary instructions so that a uniform method may be followed by the Income-tax Officers dealing with Co-operative Society's case.

4. Management Expenses.

The next point that was raised was that if the investments of the bank outside the activities of a Co-operative Society was decided to be taxed on the footing that the bank carried on business in securities, the deputation pointed out the extreme advisability in such a case to instruct the Income-tax Officer to allow expenses of management on these securities in proportion that the total investment income which is liable and not liable to tax. At present, no allowance is made except a very nominal amount against the interest income of these securities which is subjected to tax.

The Member observed that only so much of the expenses as would come within the purview of Section 8 of the Income-tax should be allowed.

5. Housing Co-operative Societies.

The deputation also raised the question of exempting housing societies from payment of income-tax. The Member, however, expressed his inability to do anything in the matter particularly as under Section 60 no further allowances can be granted and he was also not convinced that there was any hardship in taxing Co-operative Housing Societies.

6. Uniformity in Arriving at Assessable income of Co-operative Banks.

Lastly, the deputation impressed upon the Member that in different parts of the Province different Income-

tax Officers follow different methods of determining the total assessable income of Co-operative Banks. There was no uniform method either from place to place or from year to year in the same place. This created a great deal of inconvenience to co-operative banks in arriving at the total assessable income and most of them could not make provision for income-tax from the profits of the year to which it related.

The Member desired the deputation to submit a memorandum setting forth the difference in methods followed by various Income-tax Officers and also their suggestions as to the best and equitable method which could be uniformly adopted.

Variations in models of assessment of different Co-operative Banks under the Indian Income-tax Act by Income-tax Officers in Bombay Province.

(1) East Khandesh Central Co-operative Bank, Ltd.

(a) Overdue interest is added to the co-operative business profits although it is not regarded as income under the Co-operative Societies Act and credited to overdue interest reserve instead of interest account in the accounts.

(b) Profit on sale of securities has been held at capital gains not liable to tax and not treated as part of co-operative business profit.

(c) The total working capital of the Bank for the purpose of calculating the deduction for proportionate interest on borrowings has been worked out on the basis of the figures shown in the Balance Sheet as at the end of the year instead of taking the average figure.

(2) Belgaum District Co-operative Bank, Ltd.

Interest paid on borrowings is allowed wholly against taxed securities instead of allocating between taxed and tax-free securities.

(3) Surat District Co-operative Bank, Ltd.

Interest paid on borrowings is allocated between taxed and tax-free securities.

(4) Bhusawal People's Co-operative Bank, Ltd.

Profit on sale of securities is taxed under other sources. (Assessment order is not furnished but only demand notice is sent.)

(5) Karnatak Central Co-operative Bank, Ltd.

Nothing is allowed by way of management expenses against income from investments which is liable to tax.

(6) Ahmedabad Central Co-operative Bank, Ltd.

The Income-tax Officer has taxed the society on its income from Investments exceeding the total income including co-operative business profits. But on appeal the Income-tax Officer's Order has been modified by the Appellate Assistant Commissioner who held that the Society cannot be taxed on any income exceeding its total income.

APPENDIX B.

Income-tax Offices, Market Ward, Central Government Building, Queen's Road, Bombay

Dated, October 22nd, 1953.

THE BOMBAY PROVINCIAL CO-OPERATIVE BANK, LTD.
SIR VITHALDAS THACKERSEY MEMORIAL BUILDING,
9, BAKEHOUSE LANE,
FORT, BOMBAY.

DEAR SIRS,

One of my assessee's dividend income from shares of your bank. The dividend warrants produced by him show a note as under:—

"Under Government of India Notification No. 291-I-T./25 dated 25th August, 1945, the Governor General-In-Council is pleased to direct that the following class of income shall be exempt from the tax payable under the said Act, namely, the profits of any co-operative society other than the Sanikatta Salt Owners' Society in the Bombay Presidency for the time being registered under the Co-operative Society Act 1912 (II of 1912) or the dividend or other payments received by the members of any such society on account of profits."

In this connection, I have to point out that the explanation regarding the meaning of 'profits of co-operative Society' has been totally ignored by you. That explanation I am reproducing under for your ready reference:—

Explanation.—"For this purpose the profits of co-operative society shall not be deemed to include any

income, profit or gains from (i) investment in (a) securities of the nature referred to in Section 8 of the I. T. Act or (b) properties of the nature referred to in Section 9 of that Act (ii) Dividend and (iii) the other sources referred to in Section 12 of the I. T. Act”.

The above mentioned explanation makes it clear that if the dividends of a co-operative society are declared out of non-business income, *e.g.*, out of interest on securities or income from house property or dividends and other sources, such dividends, would not be entitled to exemption and would be taxed in the hands of the shareholders.

Because of your failure to reproduce the notification fully, what has happened is that my assessee has been able to get exemption from tax on the dividend income which he has received from shares of your bank and

there has been some loss of revenue to the Government. I cannot say how many other assesseees have also similarly claimed exemption from tax on the strength of the note contained in your dividend warrants and what has been the total loss of revenue to the Government of India on this account. I have therefore to request you to please reproduce the full notification in your future dividend warrants and also make it clear from what source the dividend is declared or paid.

Yours faithfully,

Sd/
Income-Tax Officer,
Market Ward, Bombay.



सत्यमेव जयते

THE BOMBAY SHAREHOLDERS' ASSOCIATION

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART I

Reply to Question No. 1—

The Primary objective of a sound tax policy is to raise revenue to meet a given expenditure in a fair and equitable manner and with a minimum disturbance of the normal working of the economy. A country's tax system is so much a product of historical circumstances that it is so much a reflection of economic and social conditions of the country that it cannot be viewed in the abstract. An objective which should always be kept in the forefront is that tax policy should not impair production or essential consumption. Inevitably, taxes are imposed on those able to bear them, but the ability to pay principle should be applied both in respect of individual taxes and in respect of the aggregate of all taxes. Tax policy should be applied in the context of the enterprise economy. Tax policy cannot be made the chief instrument of changing economic order of society even if one desires it because that would involve much wider consideration. The notion of what is fair and equitable obviously varies with time and place and with the prevailing social philosophy.

(a) Reduction in inequalities of income and wealth is an important consequence of tax policy but it certainly cannot be a fundamental objective of tax policy. It is incidental to taxation as is well indicated by Mr. J. Harold Petric in his recent book "The Taxation of Corporate Income in Canada". (University of Toronto—2.)

(b) Fostering production should be the primary objective of a tax policy. It involves encouragement to both individual and corporate, and encouragement to investment both private and corporate. It must provide incentive to work. The point where it deters people from working, from investing, from saving and from increasing production is the point where taxation is inequitable. Taxation should largely be on economic surpluses rather than on costs and prices, and economic surpluses should not be viewed in a narrow sense but should take into consideration the essential needs of development. Industrialisation in advanced countries is the result of appreciation by Government of the role of profits, large part of which are reinvested and only a small part distributed. Tax policy should be based on the recognition of the function of profits in development of existing industries and in promotion of new enterprise. One has to examine the actual growth of corporations such as Imperial Chemicals, General Motors, General Electric Company, P. & O. Shipping Co. and I. I. Steel, etc., to be convinced that industrialisation is being accelerated through profits earned and invested and that the dividend policy of these concerns is subordinated to consideration of long term development.

(c) Tax policy as an instrument of economic control has limited application. Tax policy by and large, based on assumption of normal functioning economy, cannot correct inflationary or deflationary changes. Inflationary or deflationary changes can be corrected to a smaller extent through tax policy. Tax policy is a relatively minor instrument while treatment of inflation or deflation would warrant a number of measures.

(d) Maintenance of external balance of the economy hardly can be entered as an objective of the tax system under Indian conditions.

The main modifications of the Indian Tax system suggested by the Association contained in answers to questions below are summarised here:

Personal Income-tax and Super Tax—

The Maximum tax payable should not exceed annas in a rupee. The present rate structure should be revised as follows:—

Super-tax.—Income up to Rs. 30,000	Nil
Over Rs. 30,000 but upto Rs. 50,000—A.	1
„ Rs. 50,000 „ Rs. 75,000—As.	2
„ Rs. 75,000 „ Rs. 1,00,000—As.	3
„ Rs. 1,00,000 „ Rs. 1,25,000—As.	4
„ Rs. 1,25,000 „ Rs. 1,50,000—As.	5
Over Rs. 1,50,000	As. 6

Corporation Tax.—In order to encourage small enterprises and trades to develop with their own resources we recommend that no Corporation tax should be levied on the first Rs. one lakh of corporations' incomes. Just as individual is exempted for super-tax up to Rs. 25,000 of income so also a Corporation should be exempted from Corporation tax for Rs. 1 lakh of its income. For larger corporations this will not make much difference but it will act as tax relief to smaller corporations. Such a provision is given in Canada at present.

3. Corporation tax like Income-tax should be made refundable in the hands of individuals not liable to full rate of taxation.

4. The present exemption of new industrial units from taxation of profits up to 6 per cent. capital employed should be extended to old industrial units to the extent of new capital employed for expansion or renovation. New industrial enterprises are not able to benefit from the present relief because earlier years are years of construction and establishment. On the other hand much industrial development takes place through expansion of existing units. Relief on the lines suggested by us will stimulate investment in existing units and thus accelerate the rate of industrialisation. We also advocate encouragement of corporations to create reserves for replacement and 10 per cent. of profits may be permitted to be set aside for replacement by giving special tax relief.

5. **Insurance Premium.**—The exemption of insurance premium and provident funds from taxation should be revised in respect of the existing limits. In place of 1/6th or Rs. 6,000, the limit should be revised to 1/4th or Rs. 12,000 whichever is lower. Direct encouragement to life insurance involves visible increase in new capital formation particularly from the savings of the small man.

Reply to Question No. 2—

The criteria for determining the equity of a tax system apart from the ability to pay are the effects on people's ability and willingness to work, to save and to invest. The point where the people's reaction is negative is the point where equity falls. For determining equity of the tax system we must have fuller statistical data regarding effects of total taxes on different income groups. In the absence of such information we cannot determine equity of the Indian tax system with reference to lower, middle and higher income groups. The equity is however more readily determinable with reference to individual taxes, for instance when the multipoint Sales Tax was imposed in Bombay, it was *prima facie* so inequitable *vis-a-vis* other states and *vis-a-vis* several categories of merchants in the intermediate stages that the whole population was roused. The criterion should be the reaction not of this or that person but of the class or group as a whole and the consequences of their reaction.

In a positive sense, equity of a tax system can be determined by its effects on enterprise and production and on consumption. In a negative sense equity cannot be allowed to mean bringing about equalisation of income and wealth through the tax system to such an extent that economic initiative is killed and the normal capacity of the economy to expand severely retarded. The concept of equity must be applied within the framework of private enterprise economy and not in a vague or an absolute sense.

Equity in the Indian tax system can be secured by dispassionate and continuous examination of the effects of individual taxes and total taxes.

Reply to Question No. 3—

By and large the Indian tax system does confirm adequately to the principle of ability to pay and no extension of this principle is at present desirable or practicable. While individuals in lower and middle income groups are not burdened by excessive direct taxes there is a case for some downward revision in respect of direct taxes of the upper income groups. This is particularly the case when we take note of the cumulative effects of high income tax, super tax plus estate duties plus other taxes on amenities and luxuries to which this class is accustomed. An honest person in the highest income bracket lives on his capital if he does not resort to devious ways of tax dodging. Such consequences should be avoided. The rich no less than the other classes should be encouraged to save and invest in the interests of larger good of the community and there is no reason why through the tax system he is given such a penal treatment that he is unable to play any positive economic role. So far as taxation on corporations is concerned no extension is desirable.

Reply to Question No. 4—

In our opinion there is little room for imposing additional taxation on any section of the community. Not additional taxation but additional industrialisation at a faster rate could create resources from which further tax revenue would be available. The road to further industrialisation is a hard one and the numerous practical difficulties need to be removed by helpful and even generous Government attitude. In industrially advanced countries corporations contribute a very substantial part of the tax revenue much more than the

individual. To the extent industrial corporations are allowed to grow and new corporations encouraged to come into existence tax revenue will also grow considerably. Even today Company taxation contributes nearly 50 per cent. of total revenue collected from income, super and corporation taxes.

Reply to Question No. 5—

The proportion of tax revenue to national income must necessarily be small in India because of low per capita national income. The present individual incomes are hardly sufficient to meet people's primary needs. If individual incomes grow so as to leave a surplus of income than only larger tax revenue could be gathered. It is because of this fact that the proportion in advanced countries is higher and in backward countries it is lower. The principle of ability to pay applies not only to groups or classes but also to countries. We do not believe that the proportion can be raised under existing circumstances.

Reply to Question No. 6—

We are of the opinion that the relative place of direct and indirect tax in the Indian tax system is reasonably satisfactory at present. From statistics easily available at present of Centre and States revenues taken together we find that the ratio of direct and indirect taxes is in the proportion of 20 to 80. For this purpose we have included income-tax, super tax and corporation tax under direct taxes and customs, excise, sales tax and other heads under indirect taxes. In view of this country's size, population and national income, such ratio is broadly inevitable and not unsatisfactory. If agricultural income-tax and estate duties are allowed for under direct taxes the ratio would be of the order of 25 to 75. Municipal and such local taxes are not taken into account in this calculation.

Reply to Question No. 7—

No. Non-tax revenues are not likely in the near future to occupy more important place. Even contribution of Railways to public revenue is tending to fall. The state enterprises—industrial, transport, etc., both of the Centre and States are nowhere showing profits and therefore unlikely to show any sizable surplus which go into public revenues. Several of the State concerns such as the Air Lines, Hindustan Aircraft Company, Vishakhapatnam Shipyard, Aarav Milk Scheme, Bombay, etc., are as yet losing concerns.

Reply to Questions 8 & 9—

Receipts from particular taxes may be funded or earmarked for specific purposes where there is adequate reason for doing it. But Government practice has so far been to collect cane Cess, Petrol tax, etc., for the declared purposes of being spent for the particular development and yet such funds are not so spent but included in the general tax revenue. Action should be taken to set the matter right where Government have not spent the amounts for the purposes declared. Government departure from declared purposes gives rise to public dis-satisfaction and suspicion and brings Government action into disfavour. Public declarations should be correctly adhered to in this as in other matters. When handloom industry is sought to be protected through a special cess on the textile industry, it should be pertinent to examine whether a single industry should be picked up to bear the burden and whether the funds collected are duly spent for the purpose.

Reply to Question No. 10—

As mention in Question 7, such undertakings are not yet important for revenue purposes, nor are they likely to be so in the near future. State enterprises create employment or give services but they are not yielding profits. In several cases mentioned above they continue to be losing concerns.

Reply to Question No. 11—

As in the case of the Railways, arrangements should be made under which State enterprises can contribute first a fixed return on capital employed by the State and if any surplus is left thereafter it should first be utilised for the normal development and expansion of the concern and whatever remains should be shared with the Government on agreed basis. Profits from State enterprises, to the extent possible, should flow into public revenues. Just as individuals benefit from their own undertakings so also the State revenue should benefit from State undertakings wherever possible.

Reply to Question No. 12—

Incidence of taxation on various classes of people can best be explained on the basis of their income. Rural or urban residence and occupation are relevant only to a minor extent.

Reply to Question No. 13—

Broadly speaking incidence of taxation is relatively lower on large agricultural incomes (this is also partly due to high agricultural prices) and somewhat excessive on non-agricultural incomes subject to maximum tax rates. The former situation is gradually being corrected by the introduction of agricultural income-tax. A down-

ward revision of maximum income tax and super tax rates would probably correct the latter. In the opinion of the Association combined levy of income tax and super tax should not take away more than 10 annas of a rupee of one's income. A present day tax policy should at least allow an individual to retain rough one-third of his income as otherwise there would be no incentive left to work or to save.

Reply to Question No. 14—

With relative increase in the income of primary producers resulting from high farm prices and improved cultivation, the tax burden on agricultural incomes is relatively smaller today. This process has been assisted by absence of any increase in land revenue in recent years. Moreover farm income in some parts of the country have risen relatively more as in Travancore Cochin. The cultivators growing rice and wheat have not benefited as much as the cultivators growing groundnuts, sugarcane, pepper, chillies, betel nuts, etc. Agricultural incomes in some parts of the country are among some groups of cultivators have been relatively very high and therefore such classes have benefited to a greater extent. Such results are inevitable under dynamic economic conditions and they do not warrant any remedial action.

Reply to Question No. 15—

Yes. The cost of compliance with tax regulation adds materially to the burden of taxation particularly for small traders and businessmen as in the case of sales tax, excise etc. Filling up of forms, maintaining detailed account books, etc., involve greater hardship for the small businessmen who can ill afford to engage staff for the purpose.

Reply to Question No. 16—

Tax revenue and public expenditure are obviously complimentary. But benefits from public expenditure cannot be linked with the question of tax burden as this would only help in creating confusion. Even when public expenditure and tax burden cannot be separated from each other, for the purposes of the present enquiry tax burden must be examined as far as possible in isolation.

Reply to Question No. 17—

The tax burden weighs particularly heavily on industries such as sugar and textiles. It has been computed that taxation such as excise, cane cess, etc., amounts for Rs. 25 per bag out of the ex-factory price of Rs. 75. Local taxes and rates on building in the context of rent control and high cost of construction add a heavy burden on building industry. The result is that neither the existing buildings are repaired or renovated nor new buildings constructed. Available capital assets in the country are thus allowed to decay. Building repairs and construction must be encouraged every way and relief from local taxes and Government taxes (such as Urban Immovable Property Tax, Bombay) should be generously given for encouraging capital repairs, thereby incidentally creating large employment.

Reply to Question No. 18—

The role of taxation must necessarily remain very limited in providing additional resources for general economic development. Taxation can provide for the recurring expenditure of the State including general social welfare under education, health, recreation, etc. But capital development must inevitably depend upon capital resources through borrowing in its various forms. All capital development whether private or public has to depend upon savings and tax revenue can hardly take their place. There is a large scope for tapping savings of the people under Government borrowing schemes. State borrowing must be adopted to meet requirements of the people in the interior through schemes of small savings which people can understand. In particular large savings can be collected through the post office if its banking side can be modernised so as to meet the needs of the people.

Recent success of the State Loans particularly Madras indicates potentiality of public borrowing from the country side where it is done in the right manner. Moreover, through commercial Banks and Central Bank larger credit should be made available to various sectors of trade and industries which will stimulate business activity and in turn enable the Government to raise larger sums through borrowing.

Reply to Question No. 19—

Economy in expenditure obviously gets the high priority but there is far greater room for economy in Government expenditure. Prevention of tax avoidance is also important but this partly depends upon tax rates being moderate. There is little scope under (c), (d) and (e) as mentioned above.

Reply to Question No. 20—

Additional resources for the development in public sector are not possible through further taxation but can be brought about through intensified borrowing programmes. But development in the private sector should

give equal attention from Government as it is no less important and is actually of greater importance today. Industrial development is possible only when the aggregate private and public investment continues to rise. The official attitude of preferring one to the other needs revision so that equal emphasis can be given to both.

For ensuring rapid development in the private sector general tax relief should be given in the form of depreciation and other allowances, exemption from income-tax and corporation tax to new concerns for first few years and additional incentive to such industries which the State desires to be rapidly developed through private concerns in the larger interests of the country. For this purpose it would be necessary to mark out industries and give them special incentive for specific purposes so as to encourage the flow of capital in such directions.

Reply to Question No. 21—

See Question 20. By giving special tax relief to industries in the private sector which Government marks out for rapid development capital will be made to flow in such directions. Tax concessions, protection, subsidy, licence, special facilities regarding power, transport, water, land, etc., are the different directions of active State assistance to private industry. In particular the present need is to develop capital goods industries as such. Capital goods industries are reasonably well developed. Exemption to selected capital goods industries from corporation tax for fixed period will stimulate capital formation in this field of private sector. For instance, selected existing as well as new engineering concerns which can satisfy the Government in this respect could be exempted from the corporation tax for five to ten years. Industries which supply the defence needs of the country should get priority. In U. S. A. the Government has power under Defence Mobilisation Act to grant special tax relief to industrial concerns which apply for such relief and are able to prove their case. Under this scheme new capital expenditure can be written off from current profits within a very short period. So long as tax reliefs are largely used for internal capital development the loss to Government in the short term will be more than made good by larger tax revenue in the later years arising out of larger profits.

There is no basic conflict between the needs of public and private sectors. It is a wrong official approach which regards the two as conflicting.

Reply to Question No. 22—

In absolute terms, the rate of private capital formation in recent years cannot be regarded as lower than in the pre-war years, even after allowing for the fall in the value of money. In a relative sense also there is no evidence to show that it is lower. It is probably lower today as compared to the boom years 1943 to 1946. Moreover, high prices have resulted in much larger working capital being required for inventory purposes and therefore funds are locked up which would otherwise be used for fixed capital development. With the present trend of declining prices this situation would get corrected.

(ii) Yes, with high individual income-tax and with the growth of corporations, a greater amount of capital formation in the private sector is now taking place through the Corporations.

Reply to Question No. 23—

Our analysis shows that the middle income group i.e., individuals and firms with an annual income of between Rs. 10,000 and Rs. 1,00,000 contributes nearly 10 per cent. of personal income and super tax revenue. It is therefore the most important of the three classes from the view of direct tax collection. Tax relief to this group will assist the growth of savings. In particular, limit of exemption of life insurance premium for income tax purposes should be raised from Rs. 6,000 to Rs. 12,000 and from 1/6 to 1/4 whichever is lower and this will directly result in stimulating personal savings.

Reply to Question No. 24—

The assumption of the Planning Commission about 10 per cent. of the additional output going into investment each year after 1956-57 is in our opinion largely hypothetical. No practical policy of taxation can be evolved on an assumption of this character. Tax policy needs annual revision in the light of changing economic trends. It can be the function of the Government which has to form its tax policy from year to year in the light of actual conditions. Any recommendations or realising this assumption at present would probably be unrealistic.

Reply to Question No. 25—

There is considerable regulation of consumption standards in force at present as a result of the existing price structure and import tax policies. There is little room for any further regulation. Because of our chronic poverty the margin for such regulation must remain low. For whatever regulation that is possible indirect taxes are bound to be far more effective than direct taxes.

Reply to Question No. 26—

Tax policy cannot have much direct bearing on the efficiency of productive system. The multiplicity of sales tax however does tend to affect adversely productive efficiency. An uniform Sales Tax and Motor Vehicle Tax would be desirable for rationalisation of country's tax structure.

Reply to Question No. 27—

As mentioned earlier, where any industry or group of industries are selected for rapid development special tax relief and concession to them will ensure their quick development. In this sense, tax system can be used to secure a given order of priorities in the development programme of the private sector. Because of the varied effects of tax policy which often conflict with one another tax policy is ultimately the result of compromise.

Reply to Question No. 28—

It has to secure such balance as to stimulate investment without retarding essential consumption and without redistributing incomes to such an extent as to create negative reaction on the group which is affected adversely.

Reply to Question No. 29—

Tax policy, monetary policy, direct controls are equally vital instruments of planned economic development. Any discussion about the superiority or otherwise of one or other can be of little practical value.

Reply to Question No. 30—

Yes, it tends to go a little too far.

Reply to Question No. 31—

In order of priorities, capital formation and increased production take precedence over economic equality. From the country's point of view depriving a few rich of their wealth is a question of minor importance as compared to creating new wealth which can benefit people at large. We cannot therefore suggest modifications which would secure a larger economic equality because that would retard economic progress.

Reply to Question No. 32—

To the extent public expenditure can provide better amenities to the people in respect of education, health, recreation and other social services per capita income can be said to rise thereby achieving greater equality by increasing lower incomes. Tax policy only reduces higher incomes of the few while public expenditure increases lower income of the many so far as it is spent on social welfare. In that sense, it is a better instrument for economic equality.

Reply to Question No. 33—

—No.

Reply to Question No. 34—

No addition is possible.

Reply to Question No. 35—

Surcharge on land revenue, betterment levies and agricultural income tax can bring some additional revenue where their introduction is warranted after proper inquiry. The remaining taxes are undesirable.

Reply to Question No. 36—

Levy of tax on unearned increment in value of land and other property is not desirable or feasible under present conditions.

Reply to Question No. 37—

Receipts from existing sources of revenue can increase very considerably if administrative efficiency can be improved. Far less attention is at present paid to modernising the working of Government Departments than is desirable. Not additional legislation but closer scrutiny in the administration of existing legislation can bring substantial results. This holds good in respect of departments of customs, excise, income tax, sales tax, etc.

Reply to Question No. 38—

None.

Reply to Question No. 39—

There is no case for the Centre to impose surcharges and where they are in existence they should be removed.

Reply to Question No. 40—

Inflationary or deflationary situations can be met through a combination of measures of which tax policy is but one. If tax policy were made a principle weapon of economic control taxes would be far more fluctuating than today and in consequence a new element of instability will be introduced in the working of economic system. Tax policy must be broadly stable and if it is used too freely to tackle inflation or deflation much economic harm would result.

Reply to Question No. 41—

Inflationary or deflationary conditions are so different from each other that totally different handling is necessary in each case. Direct taxes and export duties are more effective under inflationary situation while reduc-

tion of direct taxes, higher import duties and such measures are more appropriate under deflationary conditions. Psychology is vital in checking inflationary as well as deflationary tendencies. Influencing public psychology in the right direction calls for tactful handling by Govt. of a given economic situation.

Reply to Question No. 42—

Not much is possible.

Reply to Question No. 43—

Public works policies can do much particularly in moderating the forces of deflation in India.

Reply to Question No. 44—

Not materially.

Reply to Question No. 45—

Deflationary influences are rapidly growing. A trade recession is developing. Increasing unemployment is already developing into spectre. The urgent need of the moment is to put into operation measures which will increase employment and incomes. Some reduction in direct and particularly indirect taxes is called for because in many cases high taxes are the cause of high prices, e.g., Sugar, Textiles, etc.

PART II—DIRECT TAXES

Reply to Question No. 46—

The Indian Income-tax (Amendment) Act, 1939 substituted the basis of *accrual* of income (in place of the remittance basis) in respect of the foreign income of one resident in British India. The category of 'Not-Ordinarily Resident' was then introduced for giving relief to Europeans who came here temporarily for business or employment and to Indian traders abroad who had an ancestral home in India, which they might visit irregularly but enough to make them technically resident every year. Whatever might have then been the need or justification for special treatment of these groups, it seems no longer necessary or right to continue to recognise them as special cases. Under the conditions existing today the class of persons constituting the first group has ceased to exist. As regards the second group the tests prescribed in Section 4A are sufficiently wide to exclude any hardship, and if any still remains they may be dealt with by appropriate changes in Section 4A(ii).

Reply to Question No. 47—

Under the present law while a capital profit made by a Company is exempt from tax in its hands, on its distribution among the shareholders it is taxed as dividends in their hands. While this may be legally sustainable, it is entirely unsatisfactory and creates many hardships in practice. We therefore suggest that so much of the dividends as is distributed out of profits not taxed in the hands of the Company should not be taxed in the hands of the shareholders.

The strong tendency of the Department to tax surplus realised on sale of share holdings has hit hard several genuine investors. It should therefore be provided that surplus realised on sale of shares should not be brought to tax unless there is strong evidence to show that the assessee is a dealer in shares.

Reply to Question No. 48—

We are not at all in favour of taxing capital Gains. The working of capital Gains Tax from 1947 to 1949 clearly demonstrated that it has adverse effect on investments retards growth and flow of capital with all its undesirable consequential effects on volume of business activity. In particular as the Estate Duty Bill has been passed there is no justification whatsoever for a tax on Capital Gains.

Reply to Question No. 49—

The need for repatriation to India of untaxed foreign profits for the purpose of their being utilised in stepping up the industrial development of the country cannot be over emphasised. To encourage the remittance of profits made between 1933 and 1939 the Indian Income-tax (Amendment) Act, 1953 introduced provisions granting relief. Accordingly at present foreign profits made during this period do not attract taxation if they are remitted to India within two years of a person becoming resident in taxable territories. We feel that in view of the restrictions on remittance of moneys due to exchange Control prevailing in several foreign countries this period of two years is totally inadequate and should be increased to four or five years. Further at present in the case of a person who is already a resident in the taxable territories remitted foreign profits are exempted only, if they are brought into India before 1st April 1954 and half the amount is invested in Govt. securities and are kept in the custody of the Reserve Bank for two years. We are of the opinion that these restrictions are excessive. We therefore suggest that the period for remittance should be extended to 1st April 1959 and the amount to be invested in Govt. securities should be reduced to 1/4 or in the alternative the period of custody of the Reserve Bank should be reduced to one year.

Reply to Question No. 50—

We are not in favour of taxing "Bonus Shares" dividends in the hands of shareholders. It is both desirable and necessary to encourage ploughing back profits. Moreover, bonus shares represent an appreciation in the capital value of existing holdings and capital gain are not liable to tax there is no justification for taxing 'bonus shares'.

Reply to Question No. 51—

The provisions of Sections 42 and 43 and the interpretations put on them by the Income-tax Department and certain High Courts in India have considerably hampered foreign trade of the country and have created unnecessary and undue hardships for those engaged in import and export trade. We are therefore strongly of the opinion that these sections should be reviewed and it should be clearly provided that no liability to tax will arise where transactions are on a principal-principal basis. Further the distinction obtaining in the United Kingdom between 'trading in' and 'trading with' should be incorporated in our Act so that profit made on goods purchased in India for export abroad are not made liable to Indian tax in the hands of a non-resident principal.

Reply to Question No. 52—

In the past dividends received from agricultural companies were excluded from income liable to tax to 60 per cent. This position has been upset by recent legal decisions and at present dividends are being fully taxed on the ground that the source of dividends is land but shareholding. Without going into the subtle legal distinction we urge that by a suitable amendment of definitions of agricultural income, exemption up to 60 per cent. should be conferred on dividends received from agricultural companies as hitherto.

Reply to Question Nos. 53-54—

Suggestions have been made by some people that exemption from tax which is at present conferred on agricultural income should be continued or at least it should be taken with account for the purpose of determining the rate at which tax on other income is payable. Agricultural income is not present the sphere of State taxation. Apart from the constitutional difficulties involved in the above proposals certain other problems also arise. For agricultural income the exemption limit will have to be kept at a comparatively higher level. The land revenue payable will have to be considered. Further the agrarian reforms undertaken in some States have brought about breaking up of large holdings so the large landholdings with substantial recurring income will no longer be there. In view of the financial position of the States they will not be willing to surrender their constitutional right over agricultural income. In view of this, any proposal for aggregation is not easy of realisation.

Reply to Question No. 55—

The principle of spreading over a period of time irregular and fluctuating income has been recognised in Section 12A introduced by the Finance Act, 1953 provides for spreading over two to three years royalty and copyright fees for literary and artistic work. The feasibility of extending this treatment to other receipts of a similar nature e.g., gratuity, lump sum receipts in certain trades, etc., may be examined.

Reply to Question No. 56—

A charitable purpose has been defined by the Act to include relief of poverty, medical relief, education or advancement of any other object of general public utility. Putting a very narrow construction on the definition the Income-tax Department has deprived several settlements the benefit of exemption from tax. Definite instructions should therefore be issued to the effect that as long as the object of the trust falls within any of the four categories mentioned above, the income of the trust should be exempted even though the benefit is confined to the members of a particular caste or community.

It has been provided by a recent amendment that ordinarily the exemption from tax under Section 4(3)(c) will be available only if the income of the trust is spent in the taxable territories the Central Board of Revenue makes an order that relief may be granted even if the income is applied to charitable purpose outside the taxable territories. This restriction is likely to create hardship in practice. In the case of charitable trusts which have been spending their income in awarding scholarships to Indian for higher studies abroad the withdrawal of relief would be a great hardship. The law should therefore, be suitably amended so as to make it clear that where the benefit of the amounts spent ultimately accrues to the country or to the nationals of the country the exemption should be granted even though the amount may have been spent abroad.

Reply to Question No. 57—

We have no suggestions to offer.

Reply to Question No. 58—

We are in favour of continuing the concessions to new industrial undertakings for a further period of five years at least to give encouragement to industrial development. Existing industries are better equipped to undertake a programme of expansion and renovations. Concessions under Section 15C may therefore with advantage be extended to them, so that they may have the necessary inducement to expand their productive capacities.

Reply to Question No. 59—

We are in favour of giving concessional treatment for tax purposes to banking profits of foreign branches of Indian Banks to encourage them to open branches abroad.

Reply to Question No. 60—

Exemption from tax amounts paid as life insurance premia and contributions to recognised provident funds is given to encourage thrift and to enable a person to make savings during his active life in a firm which would provide him and his family with a reasonable standard of living after his retirement or his death. The limits at present provided by the Act are totally inadequate in view of the considerable fall in purchasing power of money. We feel that there is sufficient justification for an upward revision of these limits. We recommend that in the case of an individual they be increased to 1/4th of the total income or Rs. 12,000 whichever is less with corresponding adjustments in the limits for Hindu undivided families.

We invite the attention of the commission to the discrimination under the present law regarding tax relief in respect of contribution to provident funds as between provident funds for employees of Govt. and other statutory organisations and provident funds for persons in private employment. We feel that there is no justification for this difference in treatment and law should be suitably amended to give the same reliefs in respect of contributions to provident funds to private employees as are given to Government servants.

Reply to Question No. 61—

To assist industry in its programme of renovation and replacement we suggest that (a) Excess realised on the sale of a capital asset which is at present brought to charge under Section 10(2)(vii) should not be treated as income liable to taxation provided the same is utilised towards fresh capital expenditure. (b) The principle of tax-free replacement reserves should be given recognition. It should be open for every company to set aside a certain percentage of its profits as a reserve to be utilised for replacement purposes. In order that this provision may not be abused it should be provided that the amounts so set aside shall be brought to charge if they are not found to be utilised for the purpose for which they were intended.

Reply to Question No. 62—

In view of the highly technical nature of the subject matter it is desirable that it is referred to an expert body like the Council of the Institute of Chartered Accountants of India. Changes should then be made in classification of assets for purposes of depreciations and rates of depreciation allowable in the light of recommendations made by the expert body.

Reply to Question No. 63—

We are in favour of giving special tax concessions for encouraging the development of mineral resources as the mining industries require proportionately larger amount of capital as compared to other industries. The need for such concession is indeed great. The provisions of the U. K. Act in this behalf may with advantage be incorporated in our Act. The English Act provides for two kinds of allowances as under:—

- (i) An initial allowance of 10 per cent. of the capital expenditure;
- (ii) An annual allowance calculated by reference to output.

Reply to Question No. 64—

A simple way of making a provision for family and personal allowance would be to increase the first slice of income to be exempted from Rs. 1,500 to Rs. 3,000.

Reply to Question No. 65—

Section 10(2)(xv) provides that any expenditure not being in the nature of capital or personal expenditure which has been incurred wholly and exclusively for the purpose of business. The Income-tax Department not being well aware of business practices and business needs have again disallowed legitimate business expenditure particularly under the head of motor car expenses entertainment, travelling, etc. This has considerably strained the relations between the assessee and the Department has been a source of dissatisfaction and resentment. It cannot be denied that in these days of competitive business such expenses have to be incurred for retaining customers. Frequent travels have to be undertaken for the purpose of running business. The Income-tax Officer should

therefore be instructed not to be unduly strict about the amounts spent under the above mentioned heads so long as they are satisfied that the amounts have been actually spent and no attempt was being continuously made to pass off personal expenses as business expenditure. In this connection it may be mentioned that the provision prevailing in certain countries of allowing as entertainment expenses a certain percentage of profits may be adopted. For example in U. S. A. entertainment expenses are allowed up to 10 per cent. of income on uniformly to all assesses. We have also to draw attention to the discriminatory practice of Income-tax Officers in respect of allowance of motor car expenses as between limited companies and other assesses. In the case of companies, the officers are disposed to allow motor car expenses in full while in case of other assesses they disallow substantial amounts. We feel there is no justification for this discrimination.

Expenses of exploratory and development nature should be allowed in full because such expenditure would result in later years in additional income liable to taxation.

The cost of making Income-tax appeals should be allowed in full.

We further urge that the law should make it that all payments which have to be made under decisions of legal authorities should be allowed as a matter of course. Instances can be cited where the Tribunals appointed under Labour laws have awarded bonus or gratuity and the Income-tax Officer has questioned such payments on the grounds of their being excessive and not relating to that period.

Reply to Question No. 66—

(c) The degree of progression in the existing rate is unsatisfactory. The rates of super tax are very steep for lower slabs and the maximum rate is applied at comparatively lower level of income. The Indian assessee on an income of Rs. 5 lakhs pays 76 per cent. tax while in U. S. A. an assessee on this income pays 49 per cent. while in Canada he pays 57 per cent.

(d) With a view to stimulate saving and make development capital available we suggest following table of super tax on individual income:—

		Super-tax	
Income upto Rs. 30,000/		Nil	
„ Over Rs. 30,000/	but upto Rs. 50,000/	Rs. 0-1-0	
„ „ Rs. 50,000/	„ Rs. 75,000/	Rs. 0-2-0	
„ „ Rs. 75,000/	„ Rs. 1,00,000/	Rs. 0-3-0	
„ „ Rs. 1,00,000/	„ Rs. 1,25,000/	Rs. 0-4-0	
„ „ Rs. 1,25,000/	„ Rs. 1,50,000/	Rs. 0-5-0	
„ „ Rs. 1,50,000/		Rs. 0-6-0	

(e) We are not in favour of anything like a surcharge on income-tax rate. If at all a surcharge is levied in emergency, it should be on percentage basis of the existing rate.

Reply to Question No. 67—

Nil.

Reply to Question No. 68—

(i) We are in favour of the distinction between earned and unearned income. Earned income represents the result of person exertion and initiative and should therefore be given a concessional treatment.

(ii) The present definition of 'earned income' seems to us to be satisfactory.

(iii) The quantum of relief now afforded seems to be adequate.

Reply to Question No. 69—

We are in favour of stocks being valued at cost or market rate whichever is lower. The method of valuation should be uniform and should be regulated by accountancy principles. We suggest that the Institute of Chartered Accountants may be requested to go into the matter from point of view of accountancy principles and recommend formula for adoption.

Reply to Question No. 70—

We have no change to suggest in the method of assessment of Hindu Undivided Family. We are in favour of restoring the former higher exemption limit for super-tax.

Reply to Question No. 71—

Managing Agency commission voluntarily foregone wholly or in part should not be brought to tax. This is in fairness to the Agents who surrender their right in the interests of Managed Company. No special safeguard is necessary to prevent the misuse of this concession as the Managing Agents are not likely to sacrifice the commission unless the financial position of the Managed Company so demands.

Reply to Question No. 72—

We are in favour of substituting a system of unilateral relief for the present arrangement of bilateral agreement for avoidance of double taxation. This would be convenient and advantageous for assesses and Government. The feasibility of having with other countries an agreement similar to Indo-Pak Agreement may also be examined.

Reply to Question No. 73—

The provisions regarding taxation of property income are unsatisfactory and should therefore be entirely reviewed. We strongly feel that the Municipal Taxes and Urban Immoveable Property Taxes should be allowed in entirety. These should categorically be included in the expression 'annual charge' and on that basis taken into account for purposes of determining liable to tax.

There is at present no provision for allowing depreciation on buildings on the income whereof is taxed under Section 9. All properties depreciate in value by wear and tear and therefore depreciation should be made one of the permissible deductions. We may also point out that in view of the considerably enhanced cost of repairs the present allowance of 1/6th of the annual letting value is very meagre and should be considerably increased.

Reply to Question No. 74—

The Indian Income-tax (Amendment) Act of 1939 gave to the Assessee for the first time a right to carry forward his business loss and set it off subsequent years profit. This right has been hedged around with so many qualifications that it has lost much of its significance. One such qualification is that the loss carried forward can be set off against the profits of subsequent six years only. We feel that there should be no such time limit as new business enterprises are likely to make losses for the first few years. Another limitation existing under the present provisions is that the loss sustained in any business can be carried forward and set off against profits in subsequent years from the SAME business only. Apart from the difficulties and arbitrariness involved in the determination of the question whether two business are same or not, this limitation creates undue hardships and difficulties in practice. An assessee owing more than one business is very likely to discontinue that business which is making losses with the result that while he will not have the benefit of the carry forward provisions he will be called upon to pay tax on other business income. This is bound to seriously dislocate even those businesses of his which are yielding profits.

Further the Finance Act, 1953 has introduced an amendment which violates all principles of equity and justice. It provides that speculation losses shall be set off against speculation profits only. This artificial splitting up of present income into watertight and exclusive categories is both unjustifiable and unjust. It should not be forgotten that income-tax is a tax on income. For an assessee whose business profits have been wiped out by speculation losses, tax levied on business profit without considering the losses would become in effect a charge on capital. The Govt. should make efforts to find out bogus losses rather than introduce a general provision which will result in great hardship and injustice to honest and law abiding assessee.

Reply to Question No. 75—

The provision relating to advance payment of tax was essentially a war time measure and was introduced for the purpose of countering inflationary forces. Now that more than seven years have passed after the cessation of hostilities we feel that there is no longer any justification for continuing the system. Quite apart from this, the provision has very often placed business men in a difficult position particularly during periods of business recession and undertaken business conditions. It becomes virtually impossible to estimate accurately the business profits that are likely to accrue to them. They therefore find themselves on the horns of a dilemma. Either they have to pay as per the demand of the officer or submit their own estimate and pay accordingly. While the first alternative would mean unnecessarily blocking up the much needed funds with the consequent financial strain, the second alternative will involve a risk of their estimate falling short of the final demand by more than the permissible margin and the consequent penalty proceedings. Another very undesirable effect of this provision to which we must draw attention has been that Income-tax Officers having secured advance payments of tax are very much disposed to keep the assessments pending for a very long time. The removal of the system will induce the department to expedite the assessment for meeting revenue needs of the Govt. If some form of advance payment is found desirable we suggest that the present provision may be substituted by providing for compulsory payment of tax within 3 months of submission of the return, the liability being determined on the basis of the return.

Reply to Question No. 76—

Under the present provisions the period of limitation for the reopening of past assessments is unduly long.

The assessee is obliged to maintain all their accounting records of any one year for as long as eight years thereafter. Further for this long period the fear and anxiety of their assessment being reopened is on their heads. This creates undue hardships for businessmen both big and small. We therefore suggest that the period should be reduced from eight to four years in cases falling under sub-section 1(a) and from four to two years in cases falling under sub-section 1(b). Incidentally, we may suggest that for the same reason the period of limitation under Section 33B should be reduced from two to one year.

Reply to Question No. 77—

We have to suggest the following measure for simplification of the assessment procedure in order to reduce the cost of compliance with tax regulations.

(1) Whenever there is a transfer of an officer he should be given sufficient notice and asked to complete all the pending assessments on that date. He should also not be given fresh cases.

At present what happens is that an Officer who has heard the case of an assessee leaves the same even at an advanced stage to a new Officer. The assessee is then required to bring all the papers again to satisfy the new officer on the same points as were dealt with the first officer.

(2) When Notices under Sec. 22(4) and 23(2) are issued the same should be accompanied by a list of all the detailed requirements of the Officer so that the assessee may bring all the papers at one time. As far as possible a case should be completed in one or two sittings at a stretch. At present our experience is that many cases last for months together and change hands from one officer to the other till the assessee is tired and gives up his real dues.

(3) There should be proper sitting arrangements in every Income-tax Office for the assessee and their legal representatives.

(4) The Income-tax office should maintain a library for the use of the assessee as well as for their legal representatives.

(5) The promotion of an Income-tax Officer should not depend on the number of cases disposed off by him and the tax collections made by him. It should depend on the satisfaction he has been able to give to his assessee and the number of appeals decided in his favour.

(6) When an assessee desires to file an appeal against any order under Income-tax Act, except an order under Section 46, payment of tax may be stayed till the appeal is decided at the Tribunal Stage. This will prevent the Officers from making reckless assessments to fight for their rights without the fear of the officer. In order, however, to discourage frivolous appeals it should be laid down that an assessee who has lost his appeal will have to pay some penalty which will cover the cost to department regarding the said appeal.

Reply to Question No. 78—

We are in favour of giving the Tribunal powers to enhance assessments. The Department is free to go into appeal to the Tribunal and therefore there is no case whatsoever for giving such powers to the Tribunal.

Reply to Question No. 79—

We are not in favour of introducing an element of progression in Corporation Tax.

Reply to Question No. 80—

We do not advocate different rates for different types of corporate enterprises. We do however suggest that concessional treatment should be given to small industries and cottage industries for encouraging their growth. With a view to assist small enterprises we urge exemption from corporation tax of first Rs. one lac of Company's income. Just as individuals are exempted from Super tax up to first Rs. 2,500 of the income so also companies should be exempted up to Rs. one lac of their income for Corporation tax so that the smaller units may specially benefit.

Reply to Question No. 81—

It is a basic principle of sound and equitable tax system that same income should not be subjected to double taxation. We therefore suggest that the provisions of Section 49B of the Income-tax Act should be extended to cover Corporation tax. Every shareholder must get credit for the Corporation tax paid by the company. Both Income-tax and Corporation tax are taxes on income therefore there should be no discrimination between them in the matter of giving relief in the shareholders.

Reply to Question No. 82—

We have no comments to offer.

Reply to Question No. 83—

We are in favour of differentiation being made between distributed and undistributed profits of companies for tax purposes. This is necessary for encouraging the companies to plough back profits which is so essential both for expansion development and consolidation of

their financial position. The concessional treatment given to undistributed profits should be available to all industries.

The provisions of Section 23A are far from satisfactory and they require to be completely reviewed. In the first place the question of liberalising the compulsory requirements of the section so as to allow sufficient freedom and initiative to the shareholders of private companies to conserve a portion of their profits for expansion purposes needs to be examined very carefully. Private companies no less than public companies require funds for development. Private companies should not be obliged to borrow funds for this purpose when they could have ploughed back profits without any difficulty. Further sufficient flexibility should be introduced in the section to overcome difficulties in the practical working of the section. Due to the foreign exchange restrictions in many foreign countries private companies cannot remit the profits of their foreign branches. They cannot therefore with the requirements of the section. In such cases, foreign profits should be excluded for arriving at the amount to be distributed. Similarly, public charges like Municipal taxes, cesses, etc., which the company is bound to pay should be allowed as legitimate deductions though they may not be permissible deductions for purposes of income-tax. Where by reason of an honest difference of opinion between the Company and the Officer the amount distributed by the company falls short of the required percentage the company should be given an opportunity to make up the required amount even the amount initially distributed is less than 55 per cent. The inspecting Assistant Commissioner should be empowered to withhold his consent for certain reasons even when he finds himself in agreement with the Income-tax Officer that the conditions prescribed by Sub-section (1) exist.

Reply to Question No. 84—

As stated above there is all justification for giving credit to a shareholder in respect of Corporation tax paid by the company. If this is accepted their charging to super tax dividend income in the hands of the shareholders. In case the present position is continued the dividend income which has already borne Corporation tax should not be charged a super tax again.

Reply to Question No. 85—

In recent years the State has been actively participating in industrial and commercial activities and has entered into competition with private enterprise. For the purpose of securing conditions of fair competition it is suggested that State enterprise should not be entitled to any concessional treatment. They should be obliged to pay the same taxes as private concerns it is necessary that State conducted enterprise should be put on a par with private enterprise in respect of payment of taxes and all other matters.

Reply to Question No. 86—

It should be entirely left to the discretion of the assessee whether they should employ Chartered Accountants for handling their taxation matters. Where however, an assessee to enlist the services of a Chartered Accountant, the accounts submitted under his signature must be accepted by the Department as a matter of course.

There should not be standardisation either in the matter of certificate to be submitted by Chartered Accountants or in the matter of fees payable to them for services rendered.

Reply to Question No. 87—

We have no suggestions to make.

Reply to Question No. 88—

The punishment provided at present under the Income-tax Law for evasion of a tax is in our opinion, adequate. There is therefore no need for the vindictive measure of publishing the names of these persons who are penalised for concealment of income.

Reply to Question No. 89—

Normal perquisites given to employees in the shape of allowances for specific purposes should be excluded for computing the tax liability of the employer unless the income-tax officer has reason to believe that they are disproportionate and are given for the object of reducing tax liability.

Reply to Question No. 90—

We have no change to suggest.

Reply to Question No. 91—

The powers which are at present vested in the officers of the Department are more than adequate. No new powers of any nature whatsoever should be conferred on them.

Reply to Question No. 92—

Several decisions of High Courts both in India and abroad have laid down that a citizen is perfectly entitled to exercise his ingenuity in so arranging his financial affairs as to reduce his taxation liability. He may resort to any devices which are open to him within the

framework of law. There is nothing immoral or anti-social about it. The use of penalty rates for minimising such practices is totally unjustified and unnecessary.

Reply to Question No. 93—

Under the existing provisions the profits of a registered firm are not taxed in the hands of the firm but in the hands of the individual partners. The tax liability is therefor of partners individually. The unrealised tax of any defaulting partner should not therefore be recovered either from the firm or other partners.

Reply to Question No. 94—

The present arrangements relating to recovery of income-tax are adequate. No separate machinery for enforcing the recovery of arrears of tax is necessary.

Reply to Question Nos. 95 & 96—

Nil.

Reply to Question No. 97—

The absence of good relations between the assessee and the Department has been a source of much dissatisfaction and bitterness. All efforts of the Department should by their conduct show that they are not tax-grabbers but referees standing between the State on the one hand and the tax payer on the other with the sole idea and desire that both the parties get a square deal. It is than only that they will receive encouraging response from assessee. For small assessee a separate Department should be set up which would give them free advice, explain them their rights and obligations under the Act, see that all their complaints are properly and expeditiously attended to. It should not be very difficult for them to meet superior officers. The Department's attitude towards big assessee should also be drastically changed. The Officers should not look upon them with suspicion and distrust. Their request for extension of time for submission of return, instalments for payment of taxes, keeping the disputed portion of tax in abeyance should be sympathetically and favourably considered.

The Income-tax Officer should plan their work well so that it may not be necessary for the assessee to wait for unduly long periods or attend the office a number of times. They should as far as possible keep the appointment except for certain unforeseen reasons it is not possible to do so. The assessee should be informed and alternative appointments given.

Reply to Question No. 98—

(i) *Issue of Notices.*—Notices should state precisely the requirements. This would relieve the assessee of much inconvenience.

(ii) *Simplification and filing of returns.*—We have no changes to suggest.

(iii) *Levy of Penalties.*—Penalties should not be imposed out of spite and vindictiveness and for the purpose of augmenting the revenues. Penalties for offences of technical nature should generally be avoided.

(iv) *Headway of tax.*—In the case of big demands facility of easy instalments should be granted as a matter of course. Disputed portion of the tax should be kept in abeyance unless the claim of the assessee is very frivolous.

(v) *Appellate Procedure.*—In the interests of justice it is very desirable that Appellate Machinery should be completely separate from the administrative machinery. The Appellate Assistant Commissioners should be placed under the control of Income-tax Appellate Tribunal so they can discharge their functions without interference.

Reply to Question No. 99—

There is a general complaint that undue delay occurs at present in the course of assessment proceedings. The frequent transfers of Income-tax officers, the undesirable interference in day to day affairs by Inspecting Assistant Commissions the system of advance payment and unduly long limitation period of four years are the failures that are responsible for this sorry state of affairs. We have elsewhere suggested that system of advance payment should be discontinued and the limitation period should be reduced to two years. The Income-tax Officers should be given greater freedom and initiative and they should not look to Inspecting Assistant Commissioners for guidance in every case. Where there is a transfer of the officer, the new Income-tax Officer should pick up the case from where his predecessor had left.

Reply to Question No. 100—

We have no suggestions to make.

Reply to Question No. 101—

We have no suggestions to make.

Reply to Question No. 102—

We have no suggestions to make.

Special Note on Question No. 74—

Section 24.—We take the most serious objection to the Clause 3(2) of the Finance Bill, 1953 amending Section 24 under which losses from "speculation" cannot be set

off against other income of a person and are allowed as set off only against and up to profits from speculation if any.

A highly arbitrary concept has thus brought in which seeks to divide personal income into two parts, viz., income from speculation and other income. Where there is profit from speculation it is added to other income for tax purposes, thus treating the two parts as single income. Where however there is loss from speculation it is not allowed to be set off against other income except to the extent of profit from speculation if any.

The assessee is thus put to a most impossible situation as having made an aggregate trading loss and yet being called upon to pay tax on his so-called other income. He has to meet trading loss in the market and at the same time he is assessed to taxation which he is in no condition to pay. The assessee may thus driven to bankruptcy on account of this tax provision which is grossly inequitable and has no parallel in the tax system of any other country. The inequity arises when a person has other income and makes losses in speculation which the tax law segregates as something distinct and disallowable against other income. Assessee who lose in speculation take that risk because of other income and by dividing arbitrarily a person's single income into two water-tight compartments of which one part is wrongly inflated by disallowed loss, he is made to pay higher taxes which he is no position to pay because of trading loss sustained. Not only will the assessee be driven to bankruptcy or made to pay higher taxation through arbitrary and unwarranted inflation of his income but, incidentally, bulk of the normal trading on all forward markets would be put a stop to, thus compelling in due course the closure of all forward markets due to decline of trading activity which is already at a low ebb. If the Govt. desires closure of forward markets, even after recent legislation seeking to regulate forward markets this is a devious way of doing it. The present provision is a serious bar to all legitimate and normal risk taking in trading markets.

Even when section 24 is amended by the Finance Bill 1953 so as to protect the "investor" as distinct from the "trader" discussed above, definition of "speculation" and the permission for hedging, etc., is creating great confusion and making it impossible even for tax authorities to assess individual cases justly and correctly. Though the amendment is recent it is already creating havoc in individual assessment and calls for its immediate repeal before it can do greater harm.

Curiously enough where a person has income only from speculation this section does no harm, thus providing that the pure speculation can go about freely but not the investor or investor-cum-trader. This is a measure of the inequity as well as futility of this amendment.

The declared object of ending the practice of Hawala or fictitious buying up of losses for reducing tax liability for which the amendment was brought cannot be achieved by this amendment. On the other hand it imposes grossly unfair burden on innocent assessee and gives rise to much injustice in tax collection and may even put a stop to bulk of trading activity in all forward markets.

PART V

Reply to Question No. 163—

The History of Stamp Duty on Forward Market transactions dates back to years before 1932. On Stock Exchange Transactions, before 1932, the duty was As. 2 for every Rs. 10,000. From April 1932, it was raised to As. 2 for every Rs. 5,000. In year 1938, it was raised to As. 2 for every Rs. 2,500. On 1st April 1944, a surcharge of 50 per cent. was levied making it As. 3 for every Rs. 2,500. From 1st April 1950, the duty has been at As. 2-3 for every Rs. 2,500.

This rate is therefore 4½ times of the rate at which the levy was started. Confining ourselves to the duty on the Stock Exchange alone, we would like to point out the effects of this stamp duty on the working of the forward markets. Starting at an yield of Rs. 10 lakhs to the revenue, the Bombay Stock Exchange alone gives Stamp Duty collection of Rs. 20 lakhs today. With 300 active Members of the Association, this acts as a professional tax of Rs. 7,000 per broker to the members of the Stock Exchange. This tax is paid besides the usual payment of income-tax and other taxes and therefore acts very adversely on the turnover of the Stock Exchange. There is also inequity in this tax that while on all other transactions stamp duty is payable once on the purchase and sale, the stamp duty on the Stock Exchange transactions is double in character because both the buyer and the seller pay the Stamp Duty. Again, Budli transactions which are only giving effect to continuing the same transactions for a further period bears also the same stamp duty as an ordinary transaction. Hence, budli transactions ought to be omitted for the purposes of stamp duty. Again jobbing transactions are also dealt with in the same way with the result that these transactions are unable to bear the present high rate of duty and therefore liquidity on the Stock Exchange has materially suffered.

Again, the Stamp Duty is different in different States with the result that a transaction of the same type of share has to bear different stamp duty in different States. In Bombay, a dealer in Indian Iron shares would pay higher duty than what is paid in Calcutta or Madras with the result that there is an artificial transfer of business from one place to another. We therefore would suggest that there should be substantial reductions in the levy of stamp duty on the Stock Exchange transactions as pointed out above.

FEDERATION OF ALL INDIA LOCAL AUTHORITIES, BOMBAY

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART VI

Questions 185 & 186—

We consider that the system of Local Taxation in India is far from satisfactory and the defect is of the frame work and is also operational.

Local Government and Local Taxation in India have not had the free and natural growth they had in the countries of the west. The desire expressed in Lord Ripon's famous Resolution of 18th May, 1882 that Provincial Governments should apply to their financial relations with Local Bodies the Principle of financial decentralization which Lord Mayo had introduced and which had worked satisfactorily between the Government of India and the Provinces, still remains unfulfilled and an ideal to be attained. The approach adopted by the Provincial Governments had been halting, suspicion-ridden, and step-motherly, and the Governments have progressively evolved a set up which is cramping, unhealthy and stifling for the free and Natural Development of Local Self-Government in India. With the impetus given by the Liberal Policy pursued by Lords Mayo and Rippon, and the background of the recommendations of the Royal Commission on decentralization in 1907-08, accepted by the Government, the Montague-Chelmsford Report of 22nd April 1918, suggested that "there should be complete popular central in Local Bodies, and the largest possible independence for them of outside central" and this suggestion was accepted by the Government of India in its resolution of May 1918. Under the scheme of the Government of India Act, 1919, Local Government became a transferred subject and in implementation of the policies laid down in the Government of India Resolution of May 1918, several Acts have been passed by the Provincial Legislative Councils giving full control over the institutions to elected representatives, and giving them a wide

choice of levying and collecting taxes, etc. Under the "Schedule Taxes Rules", the taxes which could be imposed by the Local Bodies were separated from those that could be levied by the Provincial Governments, and the way had been forged for transforming the ill-nurtured Local Bodies into units of self-governing institutions with substantial powers and potential for development within the framework of the State superstructure.

But all this had been undone by the Simon Commission Report of 27th May 1930, and the Government of India Act of 1935 and the clock had been set back to the pre-1919 period, much to the prejudice of the orderly growth and development of local Government. Many Chairmen and members of the Municipal Councils had been in the forefront of the freedom-Movement launched under the leadership of Mahatma Gandhi, and the Galaxy of National Leaders that occupied the front ranks like Sardar Patel, C. R. Dass, Pandit Jawaharlal Nehru, Subhas Chandra Bose had at sometime or other in the post "2" period, played a prominent role in the building up of Local Self-Governing institutions and had endeared themselves to the people by their selfless service and their fearless resistance to the Beauracratic alien Government of the day. Though they boycotted the Legislative Councils constituted under the Reforms, they readily realised the potential strength under having the Local Bodies and were none too loath to snatch the opportunity presented to them, and by occupying positions of vantage as heads and influential members of these bodies, gave more than one headache to the British Government and their benchmen in the provincial cabinets and Governments. They were also in the forefront in organizing Hartals and black-flag demonstrations against the Simon Commission and the idea took root that unless the autonomous status and growth of the Local Bodies was effectively checked, they constituted a potential of grave danger to the British Government.

With this over-riding object in view, the Simon Commission had suggested the fastening of a death-grip over these institutions by the Governments and a series of enactments were passed by the Provincial Legislatures of the day, reducing the Local Bodies to the position of a mere congregation of Yes-men without any control over the administration, and simultaneously developing a hierarchy of officials, not for the purpose of helping and guiding the elected bodies, but to serve as the eyes and ears of the Government in those bodies, with unlimited and over-riding powers over the administration. Thus had developed a system of bureaucracy in the domain of Local Government stifling all initiative, and cramping progress and growth; and while the force of Governance by elected representatives had been retained and even liberalized, the substance of power had been withdrawn and concentrated in the hands of the Governments and their benchmen. Thus the Government of India Act of 1935 while granting Provincial Autonomy, had hung the death-nell of Local Self-Government in India and unfortunately for us, the position remains the same even today, in spite of the inauguration of a sovereign independent republic, and the framing of a most glorious constitution. The same enactments, and rules the same G. Os., and Circulars still hold the field aloft, and the Local Bodies have no place in the Polity of the Nation, except as orphans entrusted to the benign care of the States.

The question naturally arises: Is this the set up we had fought for and sacrificed and which our Leaders had aimed at in framing the Constitution?

The answer is an unhesitating "No". The Police State under the British Rule is replaced by the welfare State and the Constitution Act recognizes Local Authorities as component units of the State (*vide* Arts. 12 and 36) and aims at developing them by investing them "with such powers and authority as may be necessary to enable them to function as units of Self-Government (Art. 40). We are confident that it is in the process of the fulfilment of this objective that the Government of India have constituted the "Taxation Enquiry Commission" as the first step and an essential step, and that the commission has a historic and valuable role to play in shaping the new set-up of our Polity.

The time has now arrived when we have to face the problems fairly and squarely and any hesitation, suspicion or fear in facing the problems will perpetuate the same evils that have cramped all growth and advance, these twenty years or more.

Our President Shri R. R. Sidhwa, who has been member of the Constituent Assembly had suggested to the Assembly, when the constitution was being made, that there should be a separate list for local bodies like Union, concurrent, and State lists, so that the Local Bodies' privileges, rights, responsibilities, duties and allocation of funds may be recognized. There was opposition from some State Governments and his suggestions were not accepted. We fully endorse the views of our President Sidhwa that the time has come that the change should be made under the circumstances. Unless a new list is added to the schedule mentioning the allocation of funds on the various heads, as suggested by us in this report and also the grant-in-aid, we are quite sure, State Governments will not part with their finance on the ground of stock argument that their finances are under depleted condition. This kind of affairs namely low-funds of States are not going to improve and if the Local Bodies are to exist and the progress of democracy is to depend on local bodies than in our opinion the solution suggested above is the only course.

(1) We therefore urge that the Local Bodies should have a defined place in the constitution and if needs be, the constitution may be amended by including Local Authorities as units of the term "State" and apportioning the Taxable items between the three units afresh. In addition to the three lists a IVth List may be added to the VIIth Schedule, defining the "Local Bodies" powers of Taxation. This we are urging with our bitter experience during these two decades and more, and on the analogy of the "Schedule Taxes Rules" of the pre-1935 period. The Historical Development of the States themselves in the British period from being mere agents of the Central Government prior to the '19 Act into fulfilled provinces with autonomous powers under the 1935 Act, and their evolution as States of the post-Constitution Era, furnishes us with historical justification and re-enforces our Demand.

(2) The elected councils and boards should have complete autonomy and power over administration and the office, and the interference and stifling control over the day-to-day work, forcing the elected bodies into a position of abject dependence on the State Government should be done away with. The commissioners and executive officers created during the post-'30 Era by the bureaucratic Government and fastened on them as Agents of the Government should be relegated to the administrative field and should function as subordinates of the elected Heads of the respective bodies. The position they now occupy as one of the three component

authorities constituting the Local Body, *viz.*, the Council or Board, the Chairman or President and the Executive Authority, is a negation or Democracy and popular Government. Even the Decentralization Commission had recognized the justness of demand for control over the staff.

(3) There should be a re-orientation of the approach to problems of (a) Health, (b) Education and (c) Housing which involve huge capital outlay and recurring expenditure.

It is the primary duty of the State to improve Public Health (Art. 4 of the constitution) and to educate its citizens (Art. 45) and to shelve the entire burden of this huge undertaking on the slender resources of the Local Bodies, is violating the spirit of the constitution. The term "State" in this context includes the Governments of the Union and States and the Local Authority (Art. 12) and to make the junior partner alone responsible for these tasks is in effect tantamount to denying for ever, fundamental amenities for the people like protected water supply, drainage, child and mother-care and education. These should be recognized as "National" services and not merely "Local" and a sense of this recognition has contributed to the building up of these services on an efficient and effective scale in the western countries, especially England. After the advent of the constitution it is no longer open to the Central Government to shirk this prime-responsibility on the plea that it is a provincial subject and in a way this responsibility has been recognized by the Planning Commission. But it is disappointing to note that the Report of the Planning Commission does not envisage any improvement in urban areas, where 1/6th of the total population of India is concentrated and it is hoped that the next Five Year Plan will be more comprehensive. But for the present it is suggested, that in addition to the percentage grants made by the Provincial Governments for specific services, a divisible pool of Block Grants may be built up in each State with contributions made by the Centre and the State, to be allocated to backward Municipalities and Local Boards, to attain the minimum standard of efficiency and effectiveness. This is what is called "Equalization Grant 'or' New Money" in England, and the basis of "weighted population", weighted by the factors of unemployment, area, and road-length compared to the density of population, etc., may be adopted for allocating these grants. Under the present set up, Rich Municipalities and Corporations alone can claim some percentage grants, the poorer bodies can scarcely maintain their service, even at the minimum standard of efficiency let alone starting of new services.

(4) Land Development should be the sole concern of the Local Bodies and Government waste or Nagul lands should be assigned to them for purposes of development. The Local Bodies may reclaim and develop these lands and after finalizing the layout, sell then in convenient parcels and thus supplement their slender resources for bettering their roads, etc. Better still, they may construct tenements and flats with the aid of the Government and rent out the same on economic rents. The Policy obtaining in England may profitably be purchased in this connection. The establishment of Local Finance Corporations in each State with the assistance of the Union and State Governments and the Local Authorities in the State, for financing such and other remunerative schemes may be tried in one or two States at the outset.

(5) The Loan Policy of the Local Bodies should be placed on a sound and scientific basis. As in England, the Government may float a consolidated loan every three or five years after consulting the Local Bodies about their capital requirements during the period as per approved plan. In approved cases, the Local Body may be permitted to float its loan, the Government Standing Guarantee as in the case of Land Mortgage and Co-operative Banks. The Present policy adopted by the various Governments of neither advancing loans themselves, nor permitting local bodies to float their own loans for approved purposes, is futile, barren and inept and should be revised immediately. The success of Local Government in England is largely due to the liberal grants-in-aid and Loan Policy progressively adopted by the Government, and this fact should be appreciated.

(6) The various Local Boards and District Municipalities Acts should immediately be revised, so as to have a Panchayat for every village or group of villages with 2,000 to 5,000 population, a Major Panchayat for 5,000 to 20,000 population and a Municipality for all towns with over 20,000 population. For towns with population under one lakh. The Borough Municipal Act may be applied and for towns with over one lakh population, the Corporation Act may be applied. But these should be a uniform Act for each of these categories. The Bombay and Madras Acts, being slightly progressive, they may be adopted with necessary alterations and additions.

(7) The Local Bodies List of Taxable Items may comprise the items of taxation now embodied in the foregoing Acts with suitable additions. It may not be out of place to mention here that the items of taxation

that were exploited in Lord Rippon's time, are still the major items that are now being exploited by the various Local Bodies. There are few more taxable items what can be added to the List, which at the same time, bear the qualities of Local Taxation. The cream of the items are appropriated solely by the Governments and the sediment that remains is neither elastic nor remunerative. In England at one time, Probate Duty and later Estate Duty was considered sufficiently local in character to be allotted entirely to the Local Bodies. Under Art. 269 of the Constitution Act, the Central Government can levy and collect (a) Succession Duties, (b) Estate Duties, (c) Terminal Taxes, (d) Taxes on Railway fares and freights, (e) Taxes on stock-exchange and future markets and (f) Taxes on sale or purchase of newspapers and advertisement but should allocate the revenue to the States. It is submitted that all these duties are sufficiently local, indirect and elastic and can properly be allocated to the Local Bodies, earmarking them for purposes of Public Health and Education of the citizens for which prime responsibility is cast on the Government of India also. In addition, it is also submitted that a divisible pool may be created in each State consisting of the Sales Tax, Motor Vehicles Tax, Motor Spirit and Tobacco Tax and Electricity duties and Excise duties levied in the State, to be apportioned between the States and the Local Bodies in equal ratio. The bulk of sales tax is realised in urban areas and there is no justification in denying them a share in the revenues. On the same basis that the States claim a share in the income tax and Excise duties collected by the Government of India, a share in Sales Tax can be properly and justly claimed by the urban councils and corporations.

The Finance Commission of 1952 observe in their report that though the provinces never had the right to levy income-tax, unlike their counter-parts in Australia and Canada, they were nevertheless assigned a share in the Revenue to establishment financial stability (pp. 67 to 71 of the report). The Local Bodies today are taking the stand that the Provincial Governments had taken in the twenties. The Central Government had retained complete control over provincial Revenues and expenditure and it was only gradually that devaluation of Financial Authority had progressively resulted. The financial resources of the Provinces were at first enlarged through fixed grants and later by transfer in whole or in part of specified heads of Revenue. The Montague-Chelmsford Report had sought to secure for the provinces a larger measure of financial autonomy, by abolishing what were known as "Divided Heads of Revenue" and by effecting a complete separation between the Central and Provincial Heads of Revenue, and by further sub-dividing the Provincial Heads under the "Schedule Tax Rules" between the States and the Local Bodies. It was only in the 1935 Act that Constitutional Recognition was accorded to the exclusive right of provinces to exploit certain Tax Heads and they continue to enjoy the status under the Constitution Act. It is but the natural process of Evolution that Local Bodies should now seek similar constitutional status with financial and administrative autonomy, to enable them "to function as units of Self-Government" (Art. 40).

In distributing the Divisible Pool between the various Local Bodies, the same principles applied for distributing the income-tax pool between the provinces be applied, viz., the needs of the different areas according to the various criteria adopted such as, area and sparseness of population, economic backwardness or the inverse relative of *per capita* income of each local area. Municipalities contributing a longer part of the Revenue are in justice entitled to a larger share and it is suggested that 75 per cent. of the local bodies' share may be distributed between the Municipalities, and the balance of 25 per cent. between the District Boards and Panchayats.

In the case of Motor Vehicles Taxation, there is no justification for denying the proceeds, to the Local Bodies as the roads are mostly maintained by them.

Entertainments Tax and surcharge on stamp duty may be levied and distributed to the Municipalities, as is being done by the Madras Government, but they should not be deduct anything over 2½ per cent. of the Revenue towards collections charges. We are opposed to Octroi and we are in favour of Transferring terminal taxes from List I.

Question 187—

Municipalities and Corporations have been covered in the foregoing paragraphs exhaustively. In the case of District Boards, their main source of income is the land cess levied by them from the inception. 10 per cent. of the Sales Tax, etc., may be earmarked to the District Boards. The Madras Panchayats Act, 1950, allots 12½ per cent. of the Land Revenue to the Panchayats, and we urge for adoption of the same Policy in other States and for an increase of the share to 15 per cent. We also subscribe to the recommendations of the Local Finance Enquiry Committee, with reference to Panchayats (Chap. XXIII, Recommendations 117 to 120).

Questions 188 to 194—

Items 52 to 54, 57, 58, 60 and 62 be brought into the proposed Local Bodies List. Entertainments Tax and Surcharge on Stamp Duty may be collected by Provincial Governments and paid over to Local Bodies, but deduction of 10 per cent. by the Madras Government is unjustifiable. A deduction of 2½ per cent. is adequate to cover collection charges. There should be no exemption of Government or Railway properties. Regarding Profession Tax we agree with L. F. E. C.'s recommendations.

Questions 195 and 196—

There are certain anomalies. Sales tax, Octroi, and Terminal Tax are of similar nature, and though they are indirect taxes, they are usually passed on to the consumer. One anomaly in this is that the Rich and the poor are taxed alike, and that happens to be the defect inherent in any indirect taxation. If our recommendation about allotment of 50 per cent. of sales tax is accepted the latter two taxes may be abolished.

Similarly income-tax and profession-tax are similar in nature, and the latter also taxes the lower income groups. But this cannot be avoided in a country which can boast of only 50,000 income-tax assesses, and the rates of profession tax generally levied are far from being oppressive. The lower income groups have also a responsibility to the community which consists of a majority of people placed in a less fortunate position than even these groups.

Under a Federal Constitution there is bound to be overlapping as people are subjected to three types of taxation: (a) Central, (b) State and (c) Local. There is also bound to be duplication of machinery. But that can be avoided by Statutorily constituting a devisible pool as suggested in the fore-going paragraphs, while at the same time maintaining a separate Local Bodies List of Tax items, since the latter does not involve duplication of machinery. People subject to central taxation are few in number and barring sales and other indirect taxes, the State Taxes do not overlap with Local Taxation.

Question 197—

(i) The Tax-borne income of the Corporation of Madras is 68.15 of the total income and works out to Rs. 13-13-6 per head of population compared to the total income of Rs. 23-0-7 per head. In Bombay Corporation it works out to Rs. 3-7-3 per head as against a total income of Rs. 44-6-7 per head and the proportion of tax borne income is 82-0-2 per cent.

In Calcutta Corporation the proportion of tax borne income is 57.90 per cent. and the tax incidence per head is Rs. 9-11-0 as against a total income of Rs. 16-12-7 per head.

The tax income for the District Municipalities in India for the year 1947-48 worked out to 68.56 per cent. of their total income and it is felt that the proportion is rather high. But this can be remedied by encouraging Local Bodies to undertake remunerative enterprises like the running of Public Transport services and the Distribution and Sale of Electricity. The Madras Government is trying to take over the Electricity Distributing concerns from its Municipalities, and we agree with the opinion of the L. F. E. C. that this is improper and retrograde.

The Hotel Sanitation Committee appointed by the Government of India had suggested the starting of Model Hotels and Restaurants by the Municipalities on Hygienic lines, but we feel that the experiment may be tried initially in Corporations and Major Municipalities. Our suggestions about Land Development and Housing in Municipal areas may also be considered in this connection.

(ii) The income from grants is pitifully inadequate. In the Madras State is worked out to 12½ per cent. of the total income of the Municipalities in the year 1951-52. It is no better in other States.

The idea that grants are made by the Governments as a sort of Charity, or as assistance offered to backward classes should be eschewed. It should be appreciated that "Grants-in-aid" are in the nature of compensation paid to the Local Bodies for discharging some of the primary obligations imposed on the State. In an extensive country like India, the system of decentralized administration is the only effective method of serving the needs of diverse areas and peoples, and for the fulfilment of the ideals of a welfare State.

In this context and set-up, Grants-in-aid occupy an important role deserving a statutory recognition as in England, where the grants constitute on the average over 40 per cent. of the total income of the Borough Councils, as against the Statutory minimum of 22½ per cent., and over 46 million pounds are distributed annually as Grants-in-aid. Hence we feel that Grants-in-aid in India should similarly be fixed statutorily and in view of the importance of the subject, a detailed reply has been furnished under Questions 185 and 186 dealing with structural alterations. We may further suggest that capital expenditure for water supply and drainage

schemes may be met entirely from Government grants for the next few years, till the finances of Local Bodies are placed on a sound footing. Similarly in the case of primary education, the State should compensate the Local Bodies in full, and should not make hair-splitting distinctions to avoid this obligation. The system of compulsory primary education should be enforced in all Municipal and Panchayat areas and the State should not stint or bargain over this important item of National reconstruction. Regarding Secondary and University Education, we are of the opinion that it is entirely the province of private societies and associations, and the present policy may be continued in respect thereof, unless there is absolute need for the State or the Local Authority taking up the responsibility in a particular area otherwise unserved.

Question 198—

This is an oft-repeated charity but by and large the Municipalities are exploiting their tax resources to the full. There may be recalcitrant bodies here and there, but they are few and far between. But the same may not be said with reference to Panchayats which have yet to develop a mature Civic Responsibility.

But in either case we agree with the recommendation of the L. F. E. C. that statutory Rating Authorities consisting of experts in Rating and valuation should be constituted. The Elected Local Bodies should not be entrusted with fixing the valuation, though they should be entirely free to levy and collect taxes subject to a Statutory minimum or maximum. The Appeal should be provided to Small Causes Court, or to special Tribunals constituted for each district. In this connection, it may be interesting to note the analogy of income-tax assessment quoted by the L. F. E. C.

Question 199—

Exhaustively covered under the foregoing clauses.

Question 200—

No State should be allowed to levy property tax in Local Body area, and the right should exclusively vest in the Municipality or Panchayat. Urban immovable property tax levied for instance, by the Bombay State, is wrong in principle and should be discouraged and prevented. If that is done, there will be very little conflict or burden of multiple taxation, as comparatively few properties are subject to Central Taxation.

The Rural value basis is usually adopted for rating residential buildings and the capital value basis for rating non-residential building. But they need not be mutually exclusive.

Question 201—

We entirely agree with the L. F. E. C.'s recommendation.

Question 202—

We are basically opposed to the idea of State levying taxes which are properly the sphere of Local Taxation. As in the case of Madras District Municipalities Act, power can be taken by the Government to enhance an existing Tax if it is considered necessary or to compel a local body to levy property tax if it fails to do so, but any attempt on the part of State Government to levy and collect a tax is fundamentally wrong.

Question 203—

We would suggest exemption of tax for buildings assessed on annual Rental value of Rs. 50 in Major Municipalities and Rs. 36 in Minor Municipalities. Educational and charitable trusts should be charged 1/4th the tax. But exemption should not cover rich societies like those started for constructing houses in Marine Drive, Bombay.

For encouraging House building in congested cities, We recommend partial exception for a period of 10 years, on a progressive basis, viz., Flats assessed on a Rental value of Rs. 25/- per month full exemption, between 25 and 75/- per month, 1/2 Tax; between 75 and 150 per month, 1/4 Tax; and above Rs. 150/- No exemption.

Question 204—

Property Tax should be progressive and based on slab-system, especially in cities and Major Municipalities.

Question 205—

It should be incumbent on all local bodies to levy property tax and the Statute should lay down the minimum and maximum. Within the limits so prescribed the Local Body should be free to levy and collect tax as it deems just and necessary.

Question 206—

The present administrative machinery is satisfactory. But to reduce accumulation of arrears, we suggest that a proper incentive for prompt payment may be provided by allowing a small rebate of say 2½ per cent. if paid within a month of the due date imposing a penalty of 10 per cent. if paid beyond the grace period.

If an assessee appeals against assessment, he should deposit the full tax while preferring the appeal.

The right of distraint and prosecution should be available to Municipalities and Local Boards even for realization of rents and profits over their properties.

Question 207—

The conception of "Service Taxes" as being justified strictly in proportion to the services rendered has no historical or legal basis, and they are not in the nature of license fees, which can be collected only to cover the expenses of Supervision and service rendered. It is therefore submitted that there is no justification for exempting any of the categories of property enumerated in the question. Even if concession were to be shown in the case of these properties, they should maintain their services efficiently and completely; otherwise they should be liable full taxation.

Question 208—

We entirely agree with the views expressed by the L. F. E. C. on this subject. We feel that the share of Land Revenue should be fixed at 15 per cent.

Question 209—

Octroi is one of the oldest forms of taxation and has been in vogue from the Maharatta and Moghul Times. This happens to be a fertile source of Revenue for Local Bodies in some States and hence they are opposed to its abolition. They plead that it is levied on a very small scale and is a fruitful source of indirect taxation not felt by the consumer direct and they contend that it is no more iniquitous than the sales tax.

But by and large it is a source of harassment at petty levels, and is liable for misuse and corruption and is beyond susceptibility of check. The federation has considered this tax as obnoxious and we stick to that opinion, after all is said in its favour. We invite attention to the report of the Indian Taxation Enquiry Committee appointed in 1924-25 under the Presidentship of Sir Josiah Stamp, who sums up his opinion as follows: "In my judgement both theoretically and on the result of experience no country can be progressive that relies to an extent on Octroi which has nearly every vice" (please vide paras 450 and 485).

Question 210—

Terminal Taxes are not liable to the same abuse as Octroi and hence need not be eschewed. But if share in Sales Tax is allotted to the Municipalities, then terminal taxes may as well be eschewed.

Terminal taxes are collected by the Railway generally by a surcharge over the ticketfare. It is a simple tax not capable of abuse. Even on goods carried by sand and water, the tax can be collected in a systematic manner.

Questions 211 to 216—

We have no comment to make.

Question 217—

Yes. Surcharge on the Railway Fare can be collected for persons entering a town or city from prescribed distances.

Question 218—

We are not in favour of "Poll Tax".

Question 219—

Motor Vehicle Taxation should properly go to Municipalities as the Roads are laid and maintained by them. A re-orientation of Policy is essential.

Question 220—

We agree with the recommendation of L. F. E. C., vide also answer to Questions 194 and 195.

Question 221—

If entertainment Tax is levied, we are not in favour of Theatre Tax also being levied.

Question 222—

We are in favour of improving the outer road by acquisition of the portion of land or building at the cost of the owner of the property as is done in United Kingdom.

If Town improvement is an essential factor to remove slums, which we consider necessary, payment of compensation for acquisition will be a heavy drag, and will never bring about the desired result.

Questions 223 to 225—

We have given our views in the opening chapter under Questions 185 and 186.

Question 227—

We are in broad agreement with the majority report. Where we have differed we have mentioned our viewpoint.

Question 228—

We welcome the suggestion to treat Manual labour as part-payment of tax. But proper standards should be fixed to avoid misuse. In undeveloped or underdeveloped areas, the contribution of Manual labour in lieu of taxes should be encouraged and utilized for building development projects or communications.

Annexure to Question No. 219—

With regard to the motor taxation and the petrol duty, we may add that it is wrong in principle for the State Government to take away the income derived from these for themselves, where as roads in cities particularly, are maintained by municipalities. Recently the Bombay Government passed an Act for increasing the motor tax rates and also duty on petrol. The Bombay Municipal Corporation legitimately demanded that they should be exempted from this additional taxation, as roads are efficiently maintained from their funds, but the Bombay Government refused to do so. As the Commission is well aware that the roads are maintained most efficiently by the Bombay Municipal Corporation at huge costs, it would therefore be unfair that they should be asked to pay 7 lakhs of rupees as additional tax which the B. E. S. T. company will be compelled to pay. To the credit of Municipal Corporation, despite this increase, they have not increased the bus fares. Had it been a private company, then surely the increase in fares would have levied and it would have been thus a burden to the passengers using this transport. It might be said here that the B. E. S. T. Company,

as far as tramways are concerned, are running under loss and that loss is recouped by profit from the buses, so profit will now be reduced to hardly a lakh of rupees per annum. You will thus see how unfair the State Governments are towards the Local Bodies and their Municipalities.

It may be mentioned that under the Five-Year Plan, a large amount is to be spent for better roads in the interior and villages. If transport is made prohibitive, then the very object of improved methods communication will be defeated.

Our Federation is definitely of the view that transport should be as cheap as possible. It is therefore suggested that in the matter of motor vehicle taxation and petrol duties, the State should not be empowered to impose duty on their sweet will to replenish their depleted finances. There must be some scientific basis of levying taxes on items which can bear the burden by an average man. Unless this method is adopted, both in the matter of transport and sales tax, our Five-Year Plan relating to communication will not be in any way beneficial to an average man.



THE FEDERATION OF ELECTRICITY UNDERTAKINGS OF INDIA

ANSWERS TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART I.—THE TAX SYSTEM

Question 17.—Do you think that the tax burden weighs particularly heavily on any individual industry or occupation? If so, please furnish the Commission with the evidence on which you rely.

The answer to this question is emphatically 'Yes' in the case of this industry.

Firstly this Industry is the only one which, so far as is known, is placed by conflicting legislation in the position of having to pay double taxation on its profits in certain circumstances.

Secondly, the burden of Tax in the shape of Electricity Duty weighs unduly upon the Electric Supply Industry. This impost is out of all proportion to taxes generally levied on the Sale or Purchase of other essential commodities.

Thirdly, the fact that certain State Governments and Local Authorities are apparently allowed to escape Income Taxes on profits they earn from supplying Electricity places the commercial suppliers of Electricity in an invidious position. These matters are elaborated upon in other places in this representation.

Question 38.—What other new sources of taxation can you recommend?

All State and Local Authorities trading in Electric Supply and other trading ventures should be made definitely liable to bear the same taxation, in all spheres, in respect of such trade, as is applicable to the trade of other elements of the commodity. See Answer to Question 85.

Question 48.—Are there any receipts or gains which are not taxed at present but which, in your opinion, should be taxed and vice versa? In particular, what is your view regarding the taxing of Capital gains?

See answer to 38 and 85. Specially there should be no tax on capital gains arising from any business activity, as all such gains will be required by the owner to secure a corresponding return, in terms of true value, in equivalent alternative activity after the original asset is sold away.

PART II.—DIRECT TAXES.

Allowances.

Question 61.—(i) Do you favour the grant of larger depreciation allowances to assist industry to finance the considerably increased costs of replacement of assets? If so, how and in what form should they be given—

- (a) by larger depreciation allowances on new assets;
- (b) by revalorisation of existing assets;
- (c) by treating the excess of replacement cost over original cost as revenue expenditure;
- (d) by any other method?

(ii) What is the justification for assistance from public resources to certain classes of tax-payers only by way of covering partially the excess of replacement cost over original cost of old assets?

(iii) In case adequate justification exists for assistance by Government in the form of tax concession to meet the situation, what safeguards should be prescribed to see that the funds so made available are utilised for the purposes for which they are intended?

This question is dealt with in the light of the peculiar problems faced by the Electric Supply Industry arising out of diverse provisions in the Income Tax Act and the Electricity (Supply) Act, 1948.

The quantum of depreciation the Electric Supply Industry can actually set aside in its books is governed by the Sixth and Seventh Schedules to the Electricity (Supply) Act, 1948. The lines prescribed in the Seventh Schedule, and the corresponding prescribed "straight-line" or "compound interest" write offs applied for determining the clear profit allowed to be earned by an Electric Supply Undertaking under the Sixth Schedule were evidently intended to ensure a relatively even spread of the cost of depreciation in this Industry, thereby avoiding a possible cause of undesirable fluctuation in charges for power.

However the later introduction of Initial and Additional Depreciation Allowances for Income Tax purposes, resulted in hugely widening the gap between an expanding Electricity Company's current statutory book depreciation and its depreciation allowance for tax purposes. It will be realised that a gap already existed by virtue of the normal Income Tax allowances being based on the "reducing balance" method of write off (which is debarred to Electricity Companies), and no additional allowances could legally be set aside in the books of the undertaking at all.

There then emerged most serious problems relative to "deferred tax liability" on the one hand and "double taxation" of income on the other, and these have been set out and explained, together with suggested solutions, in the correspondence reproduced below. Up-to-date however no action has yet been taken by the Authorities concerned to relieve this gravely inequitable position, which is undoubtedly contributing materially to inhibiting the flow of essential development capital into the Electric Supply Industry by actually penalising expansion instead of assisting it as intended.

1. The effect of deferred taxation. Proposed Amendment to Sixth Schedule, Paragraph XVII (2)(c)(ii).

(Extracted from this Federation's letter, dated 2nd April 1951 to the Hon. Minister for Natural Resources & Scientific Research, New Delhi.)

The effect and intention of the post-war taxation allowances was set out in a note which was handed to your officers during our visit. However, I would like to reiterate that these allowances do not effect any permanent reduction in taxation. They are nevertheless very likely to cause a temporary but extremely sharp inflation of profit and, where profit is limited by statute as it is in the Electricity Supply Industry, it will be evident that in order to maintain a proper economic balance, some provision must be made whereby the taxation which would have been paid can be retained in the business until tax payments again revert to a high level—a level considerably higher than that which would have been reached if these allowances had not been granted in the first place. The seriousness of the position can be gauged by the fact that unless radical steps are taken by the Centre, licensees in certain States may be forced to give rebates to consumers out of the tax not now payable, but payable in the future, and then when taxation again becomes severe, they will have to effect really substantial increases in rates. It will be clear that this situation can be avoided if provision for deferred taxation is now made. In effect then, we are merely asking permission to iron out the level of taxation in order to avoid severe rate fluctuations. This necessity has been appreciated by certain State Governments but, unfortunately, there is at least one important exception.

At our meetings with your officers, it was evident that our difficulty was appreciated although it appeared that some apprehension was felt that the setting aside of the deferred taxation liability might result in a reduction of profit to an extent which would permit rate increases to bring the profit level up to the statutory reasonable return. This is true, but it is essential not to overlook the fact that, but for these allowances, the full amount of tax would have been payable, and the burden of this would have been borne by the consumer.

I hope therefore that all your officers are satisfied that our suggestion does not penalise the consumer. In this connection, it was voiced at one of our meetings that since it is the consumer who provides the appropriation to pay the tax when it falls due, he should be credited with interest on the deferred taxation appropriation on the grounds that he may be called upon to pay taxation in advance. This contention rather loses sight of the fact that the allowances were granted to encourage expansion and that the benefits conferred by them were intended to assist in off-setting the post-war increase in the cost of plant—an increase against which even the most prudent pre-war depreciation policy could only offer meagre relief. They are therefore really intended to offset the price enhancement of capital goods by reducing for a time the additional capital which industry needed to raise in the market, thus allowing the retention in the business of taxation moneys which would otherwise have had to be paid. Industry has therefore not had to raise quite so much capital as would otherwise have been necessary and in consequence has not had to pay quite so much interest on it. The argument that the interest on this loan from the Central Revenues should be given to the consumer is therefore hardly tenable.

The issue of provision for taxation is of vital moment to the Industry and our suggestion for the proposed amendment reads as follows:—

Sixth Schedule.

Paragraph XVII(2)(c)(ii)—

"A sum not exceeding the estimated liability of the licensee in respect of taxes paid on or payable on the income of the year or which would have been payable had no allowances in respect of initial Depreciation or Additional Depreciation been made in computing the assessable income of the Company whether for that year or for any previous year".

While amendment of the Act in accordance with the above draft would resolve a major difficulty, I must again mention that the issue is one of immediate urgency. To amend the Act is certainly necessary and desirable, but in the meantime I feel that irreparable harm may be done to the Industry and to its credit in financial circles if a more expeditious method of achieving the above object cannot be found. For this reason, I do most seriously urge that, if our recommendations meet with your approval as I believe they will do, State Governments should be advised of your views at a sufficiently high level to ensure that both interpretation and procedure on this point may be uniform throughout the country to the benefit of both the Industry and the consuming public as a whole.

2. Double Taxation of Electric Supply Industry.—

(Extracted from this Federation's letter, dated 28th January 1952 to the Secretary, Central Board of Revenue, New Delhi.)

"We write with reference to the discussion which took place last month between you and a delegation of the Federation of Electricity Undertakings of India in connection with the excess dividends tax provisions of the Finance Acts of 1948, 1949, 1950 and 1951 in relation to Electricity Supply Undertakings when you were good enough to indicate that you appreciated that electricity supply undertakings were placed in a peculiar position *vis-à-vis* the excess dividends tax and it was suggested that the Federation might put up concrete proposals as to the manner in which the problem might be tackled. Before we formulate our proposals, which we shall do later in this letter, we think it is advisable to set out by way of an *aide-memoire* the considerations on which our case is based. These considerations are as follows:—

(1) Under the Sixth Schedule to the Electricity (Supply) Act, 1948, an electricity supply undertaking is required to adjust its rates for the sale of electricity by periodical revision so that, as far as possible, the "clear profit" shall not exceed the "reasonable return". "Clear profit" means, roughly speaking, profits available for distribution and "reasonable return" means a fixed percentage of the capital employed in the undertaking.

(2) In order to arrive at the "clear profit" depreciation is to be charged according to the methods and rates specified in the Electricity (Supply) Act. The rates of depreciation fixed under the Act are mandatory and cannot be varied.

(3) By reason of the initial and additional depreciation allowances granted for Income Tax purposes which have no counterpart in the Electricity (Supply) Act, the profits as computed for taxation purposes must normally, for expanding undertakings, and so long as these allowances are applicable to the undertakings, fall short of "clear profit".

(4) In view of the fact that the profits of electricity supply undertakings are limited by statute it is not practicable for such undertakings to reduce their dividends while the initial and additional depreciation allowances remain in force with a view to increasing dividends at a later date when these allowances have ceased to operate. In this connection it is also to be borne in mind that by reason of the limits placed on profits by the Electricity (Supply) Act, it is not possible for electric supply undertakings to take advantage of fluctuations in the price level which other commercial and industrial undertakings are able to do. Thus it follows, as a corollary to the proposition that the profits of electricity supply undertakings remain constant from year to year, that the proportion of book profits to be distributed by way of dividends must also remain more or less constant.

(5) It will be readily appreciated that in the circumstances mentioned above the excess dividends tax in the case of electricity supply undertakings is in effect a tax on the difference between the depreciation permitted to be charged under the provisions of the Electricity (Supply) Act and the depreciation allowable for Income Tax purposes and that unlike other commercial and industrial undertakings, electricity supply undertakings are unable to avoid the incidence of the tax. It will also be appreciated that since the depreciation allowances, both under the Electricity (Supply) Act and the Income Tax Act, cease to operate when the asset has received the full depreciation admissible the total allowances under the two acts will, in the long run, approximately equal each other. If in the earlier years of any given period the "Clear Profits" are in excess of the taxable profits by reason of higher Income Tax depreciation allowances, the converse will occur in the later years, i.e., the taxable profits will exceed the 'Clear profits'. The latter, as has already been pointed out, remain more or less constant from year to year. In these circumstances it will be seen that the amounts treated as excess dividends in the earlier years will in effect form part of the taxable profits of later years and the tax levied in respect of the 'excess dividends' in the earlier years will amount to double taxation on the same profits. If the provisions allowing a rebate of income tax on undistributed profits remain in force the

rebate will of course in these circumstances, be admissible in later years on amounts corresponding in total to the excess dividends of earlier years; but since the rebate is admissible at the rate of only one anna in the rupee and since the excess dividends will have suffered additional tax at the rate of five annas in the rupee there will have been double taxation at the rate of 4 annas in the rupee on the amounts corresponding to the excess dividends.

As we have stated the root cause of the hardship is the fact that the depreciation allowances under the Electricity (Supply) Act and the Income Tax Act differ and we therefore consider that the hardship can only be removed by eliminating this difference for the purpose of applying the excess dividends tax provisions. We would therefore suggest that having computed the total income under the Income Tax Act in the ordinary way and also the ordinary Income Tax and Super Tax leviable thereon Income Tax Officers should be instructed to substitute for the Income Tax depreciation allowances the depreciation charged in the Company's accounts for the purpose of determining the extent to which the excess dividends tax is exigible. In other words, while the ordinary Income Tax and Super Tax would be calculated with reference to the total income as computed in the ordinary way, the excess dividends taxation provisions would be applied by reference to a notional figure of income arrived at by substituting the book depreciation for the Income Tax depreciation allowance. Consequently with this suggestion we appreciate that where a rebate is admissible in respect of undistributed profits the rebate would have to be computed on the basis of a notional figure arrived at in the same way.

Closely bound up with the question of excess dividends tax is the question of the extent to which grossing up of dividends in the hands of shareholders of electricity supply undertakings is permissible. So long as a positive figure of income is computed in the ordinary way under the Income Tax Act shareholders are entitled to have their dividends grossed up. Where, however, a loss is computed for taxation purposes in the ordinary way shareholders are denied the right to gross up the dividends under Section 16(2). We would point out that where the loss for taxation purposes arises only by reason of the difference between the rates of depreciation under the two Acts the denial of the right to gross up in the case of shareholders of electricity supply undertakings involves precisely the same hardship as the charging of excess dividends tax on the difference between the depreciation allowances under the two Acts. We would therefore urge that where after adding back the difference between the depreciation allowances under the two Acts the loss computed for Income Tax purposes in the ordinary way is converted into a positive figure of notional income the shareholders of electricity supply undertakings should be entitled to have their dividends grossed up on the footing that the notional figure of income represents the total income of the Company for this purpose.

We would also urge that the suggestions made in this letter should be applied in relation to all assessments made on electricity supply undertakings under the Finance Acts of 1948, 1949, 1950 and 1951 and that instructions should be issued to Income Tax Officers to re-compute, if necessary."

It will be clear from the foregoing that not only is the Electricity Supply Industry not receiving the value of existing concessions extended to other industries in the context of your Question 61, but it is instead being put to great embarrassment by the existing practice.

Until these difficulties are resolved this Industry is therefore hardly in a position to visualise any other concessions of the same nature dealt with in your question but it has applied to Government for permission to set aside in its books (and charge as an expense in computing its 'clear profit') an additional sum annually of 1½ per cent. of the defined "Capital Base" as a Reserve for Rehabilitation.

Taxation of Companies and Shareholders.

Question 83.—Do you think that differentiation should be made between distributed and undistributed profits of companies for tax purposes? If so, on what grounds? What change would you suggest in the present quantum of differentiation in favour of undistributed profits? Should the concession in future be restricted to particular industries?

If the tax concession in favour of undistributed profits is allowed to continue as at present or in a modified form what measures would you suggest to ensure:

- that retained profits are not used as a device by shareholders of private limited companies to evade super tax;
- that retained profits are actually applied for productive purposes?

In particular, are the provisions of Section 23A of the Income Tax Act satisfactory? If not, what changes would you suggest?

Certainly no differentiation whatever should be made in the case of Electric Supply Industry whose profits are already controlled by law. In this context please see Answer to Questions 61 and 100.

Question 85.—Would you consider that industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies should be required to contribute, from their earnings in the way of income tax or in other ways, to general revenues?

There is a general tendency to make uninformed comparisons between commercial undertakings and undertakings operated by State Authorities. It is thus not only unfair but damaging to the private sector if Government operated Undertakings do not pay tax. This advantage additionally constitutes a form of concealed subsidy by the general tax payer. If the economics of a public undertaking are to be adjudged in the proper perspective, it should enjoy no undue privilege as compared to similar undertakings in the private sector. Nor should be consumer, who ultimately pays the tax through the charges for energy, have any tax advantage arising only from the ownership of the Utility serving him.

The principle that statutory Corporations should have no privilege in this matter has already been accepted in the Damodar Valley Corporation Act where it is laid down that the D. V. C. shall pay income tax on its profits. Also in the Electricity (Supply) Act which was enacted in 1948 the principle has been further extended by stipulating that for the purposes of the Indian Income Tax Act, all State Electricity Boards shall be deemed to be companies within the meaning of that Act. The fact that certain State and Local Authority Electric Supply undertakings do not pay tax at present may be one reason why a number of the States have not yet set up the much needed Electricity Boards above mentioned, as the latter would pay tax on taking over the undertakings according to law.

Special Business Taxes.

Question 100.—What, in your opinion, would be the circumstances which would justify the levy of Excess Profits Tax or Special Business Taxes?

The leading Chambers of Commerce will no doubt discuss the advisability or otherwise of levying Excess Profits Tax or Special Business Tax on Industry and business generally, but it is appropriate for this Federation to refer to the special characteristics of the Electric Supply Industry in this regard.

The earnings of Electric Supply Undertakings are at present strictly controlled by the Electricity (Supply) Act. The upper limit laid down for the time being is related to 5 per cent. on the Capital Base. Such level of earning should not in any circumstances attract Excess Profits Tax. (Or Excess Dividends Tax—see Answer to Questions 61 and 83.) With the overall earnings being limited, to an extent which it is contended is even below the ruling cost of money, no form of Excess Profits Tax should apply to Electric Supply Undertakings. The practice in the U. S. A. is to exempt Utilities from the Excess Profits Tax, except to the extent that their earnings are above 6 per cent. on the rate base. If a country like U. S. A. where electric power development is in an advanced stage had thought it prudent to extend such concession to the equity investor in Utilities, India which is on the threshold of power development can hardly afford to discourage investments in this field.

PART III.—COMMODITY TAXES (CENTRAL AND STATES).

CUSTOMS.

IMPORT DUTIES:

Question 103.—Do you think that any changes are necessary in the Indian Customs tariff in respect of—

(i) grouping of commodities; and

(iv) clarification in nomenclature and in units of measurement or weight?

Under items 72(a) to 72(e), 72(1) and 72(2) of the Customs Tariff Schedule, Plant and Machinery rank for Customs Duty @ 5½ per cent. *ad valorem*. Under item 72(3) of the Tariff Schedule component parts of machinery falling under items 72, 72(1) and 72(2) "which are essential for the working of the machinery and which have been given some special shape or quality not essential for their use for any other purpose", also rank for Duty @ 5½ per cent. Electricity Undertakings have to import such items as Electric Motors, Pumping Units, etc., which are meant for use as auxiliaries essential for the operation of the Generating Plant, but which are not admitted as such by the Customs Authorities, presumably on the basis that they do not satisfy the qualification underlined above. This position is inequitable, and it is recommended that the inequity be removed by a suitable alteration to the Tariff Schedule.

Question 108.—What changes would you suggest in the matter of granting exemptions form, or reductions in, import duties especially in regard to:

- (1) Raw materials used for essential industries;
- (2) Materials used for scientific research;
- (3) Materials imported for charitable and humanitarian purposes;
- (4) Materials imported for stimulating desirable activities, such as agricultural development; and
- (5) Necessaries of life;

This question might have sought information as to whether any special concessions in import duties are necessary to accelerate electric power development. With the question worded as it is, an expression of opinion on the point raised will not be out of place.

Both the Electricity (Supply) Act, 1948, and the Five Year Plan give an honoured place to schemes by the private sector in the country's power development, and a sizeable programme of development is visualised in the private sector. Also undertakings in the private sector will be distributing the energy generated by the various State sponsored power projects.

A concessional rate of duty of 5½ per cent. is at present applied to certain items of Heavy Power Plant, and it is for consideration that this concession be extended to all items of materials required to be imported for electric power projects (including those required for generation, transmission and distribution of electrical energy) and made applicable for the next 10 years over which period heavy augmentation of productive capacity is required. A recommendation of this nature was, in fact, made in one of the Resolutions passed at the Power Engineers' Conference held at New Delhi in February 1949. It is even for consideration that import duty on all capital goods required for Electricity supply be totally withdrawn for the next 10 years period.

Question 112(b).—Penalties.—Have you any suggestions to make regarding the administration of the Sea and Land Customs Acts especially in regard to—

- (b) penalties imposed under the Act and the appellate procedure relating to them?

In this Industry, Heavy Plant is generally imported under lump sum contracts in a large number of part-shipments. On completion of imports statements of imports are submitted to Customs Authorities. Where the value of imports falls short of the contract value, the Customs Authorities are empowered to impose penalties. The penalty, which is evidently meant to prevent deliberate undervaluation of imports, is generally imposed at a rate as high as 30 per cent., the explanation furnished by the importer being often rejected. A provision requiring the Authorities to show deliberate undervaluation on the part of the importer before imposing the penalty, seems desirable.

Taxes on the Sale or Purchase of Goods and on Advertisements.

This section is dealt with in a general way with special reference to Question 130 (iii).

Question 130.—In relation to the particular system you advocate:

- (iii) which articles, if any should be exempted altogether and why? Please elaborate the principles which, in your opinion, should underlie exemptions.

In States where a single point Sales Tax is in vogue, both electrical energy itself and all materials used for generation, transmission and distribution of energy are exempt from Sales Tax. In the States where a multi-point or two-point Sales Tax is prevalent, electrical energy itself is exempt from Sales Tax, but all materials used for generation, transmission and distribution of energy are subject to tax.

The exemption of electrical energy in all the States, and of materials used by the Electric Supply Undertakings in some States may be due either to the recognition that electrical energy is a basic tool of production or that electrical energy is already subject to an electricity duty. In either case, it is difficult to understand why Sales Tax should be applicable in some States in respect of materials used by Electric Supply Undertakings for generation, transmission and distribution of electrical energy.

It has been contended by one State that any Sales Tax relief to the Electric Supply Industry would constitute a concession to that Industry in relation to others, but this Federation can think of no other Industry in India whose end product is subject to so heavy a special tax as is the Electric Supply Industry by virtue of the Electricity Duty.

Another relevant point in this connection is that the return permitted to the investor in the Electric Supply Industry is limited by the Electricity (Supply) Act, and any relief given to the Industry must reflect in lower charges for electric energy.

Question 132.—To what extent has any desirable uniformity been achieved in regard to exemptions (in favour of "goods essential for the life of the community")—under Clause 3 of Article 286 of the Constitution? What principles would you advocate for deciding the exemptions to be made under this provision of the Constitution? Do you consider that the scope of the provision contained in Clause (3) of Article 286 should be extended also to "essential articles" which had been subject to sales tax before the relevant central enactment came into force?

Electricity, though not 'goods' should be regarded as an essential commodity and exempted from all taxation, for reasons more specifically given elsewhere in the representation. The exemptions should certainly be extended, in any case, to commodities considered essential even though such were taxed previously. Uniformity should be achieved by giving the Union Government the power to lay down the law.

It will be seen that in the section dealing with Electricity Duty the Federation has strongly urged the need for a total withdrawal of the Electricity Duty and, if this suggestion is acceptable, then but only then and solely as the lesser of the two evils, no concession by way of Sales Tax may be given to Electric Supply Undertakings, except in respect of fuel from which electrical energy is directly derived and which should be totally exempted. Even a Sales Tax of, say, 4 anna per rupee on electric energy itself (which is now exempt) would be less onerous than the present duty on electrical energy, both where Lights and Fans and industrial consumption are concerned.

Question 134.—Do you think that lack of uniformity between the States as regards the rates of Sales Tax and the methods of applying it (single or multiple point) has the effect of raising barriers in inter-State commerce or of inducing uneconomic diversions of trade? If so, what measures would you suggest to rectify the position?

Yes, certainly. The Union Government should take powers and lay down one law for all.

With electricity having come to be regarded as a basic tool of production and an important element in improving the standard of living, the ideal would, however, be that all imposts which go to increase the cost of electrical energy should be abandoned.

Land Revenue and Land Cesses.

Question 151.—Are there any suggestions which you would make in regard to the assessment of—

- (i) agricultural land in rural areas, used for non-agricultural purposes;
- (ii) land classed as agricultural but now part of an urban area and used for non-agricultural purposes; and
- (iii) land classed as non-agricultural, whether in rural areas or in urban areas, and used for non-agricultural purposes?

Electricity Undertakings, in common with other people, are much vexed at the way State Governments continue to levy non-agricultural taxes (at heavy rates based on arbitrarily assumed capital values) on properties now under the sphere of urban bodies who also levy urban property taxes on annual letting values and the like. There should be only one consolidated tax on properties in any area, and it should be a reasonable fraction of fair annual letting value.

PART V.—OTHER TAXES.

Tax on the consumption or sale of Electricity.

Question 176.—A tax on the consumption or sale of electricity is levied in several States in India. Do you consider that this is a suitable tax and may be adopted by other States? Would you restrict it to consumers of energy for domestic purposes or would you extend it to sales for industrial uses also?

This Federation records its strongest possible objection to the duty on consumption of electricity at present being levied in some of the States. The note appearing below discusses in detail the incidence of the duty in the States concerned and refers to fundamental objections to the continuance of the duty. The only criterion by which this tax may be at all thought "suitable" by some is the easiness with which it can be collected by the State Governments. The actual task of collecting the duty devolves upon the Electricity Supply Undertakings, who are paid meagre allowances for so doing. The prevalence of the duty in some States is bad enough, and any general adoption of this form of taxation will only extend the damage further afield. In other words the application of the tax in areas where development is still in its infancy will be still more harmful than it has already been in places where a greater measure of development has taken place.

While the application of this duty at all classes of consumption is retrograde, the imposition of this tax in

the case of industrial power sales is particularly so. A point which State Finance Ministers raise is that the general run of industry should not worry about the electricity duty, as the cost of electricity is a minor item of production cost. A counter argument is, which is the better way, cheap and abundant electricity or cheap and abundant tax collection? Surely, it is better to let electrical consumption develop unfettered by tax burden on the cost, so that its civilising process may produce more health and wealth, which, then, in turn, can contribute to the coffers of Government in other ways. To reverse the process as is now done, is, it is submitted, dissuading, if not killing, the proverbial goose of the golden eggs.

Question 177.—In respect of domestic purposes—

- (a) Should a distinction be drawn between the electrical energy consumed for light and fans and the energy consumed for other domestic purpose (frigidaires, heaters, radios, etc.)? On what principles would you determine the rates of duty?
- (b) What exemptions would you suggest and on what basis? Would you apply a lower rate of duty to small consumers?

The use of the term "residential" in place of "domestic" is preferable, as most of the Electric Supply Companies use the term "domestic" in a restricted sense to apply to energy consumed for such purposes as household heating, cooking, cleaning, refrigeration, etc.

(a) A distinction between energy consumed for Lights and Fans on the one hand and other residential purposes on the other is necessary if duty is in the form of a certain sum, say, Rs. 0-1-3 per unit. If, on the other hand, the duty is in the form of a percentage of the selling price of electricity, as is suggested if at all a duty on electrical energy is to be levied, then no distinction needs to be made.

(b) The existing exemptions (a reference to which is made in the note appearing below) after removing the distinctions between ordinary persons and Governments, local bodies and State Railways for reasons given in answers to Questions 38 and 85 may be retained. Care should be taken to ensure that, if and where exemptions or concessions are given for small consumers, no guillotine effect takes place at any particular level of consumption. In other words tax should come upon only "follow on" element; after the exemptions or concessions, not on all elements if above a certain level (see examples in note below).

Question 178.—If you are in favour of a duty on energy used for industrial purposes on what principles would you determine the rates of duty? What exemptions would you provide for and on what basis?

The Federation is totally opposed to any form of duty being levied on energy used for industrial purposes. This form of duty is tantamount to a tax on "an initial instrument of technological development".

This Federation is also totally opposed to any form of duty being levied on energy used for residential purposes. This form of duty is tantamount to a tax on the "health, and eye-sight" of the people.

If, on the other hand, a duty is to be imposed on either class of supply, it should be applied on a percentage of selling price basis so that the various tariff forms with their promotional aspects are not unduly interfered with and double wiring need not be resorted to merely to meet tax requirements. The duty should in no case exceed the rate applicable upon an essential commodity under parallel Sales Tax laws.

Exemption may be granted to factories which can show on the basis of audited statement that the cost of electricity consumed in the manufacturing process exceeds 10 per cent. of the total cost of production at the factory level.

Question 179 (i) and (ii).—How would you modify your suggestions in reply to the foregoing questions if electrical energy—

- (i) is entirely supplied by Government undertakings in a State;
- (ii) is supplied by Government undertakings in some areas of a State and private undertakings in other areas?

A duty on electrical energy is intrinsically bad, and should not apply to any class of supply. If a duty is to be imposed at all, there should be no distinction between consumers taking supplies from public undertakings or from investor-owner undertakings. It is the consumer who bears the burden of the impost and there cannot on the face of it be a distinction between the sources of power without giving rise to the inequities dealt with under Question 85.

Question 180.—What degree of uniformity as between different States would be desirable in regard to the levy of electricity duty? How would you achieve it?

The data attached to the note below gives an indication of the vagaries in the rate and incidence of the electricity duty levied by the various State Governments. Uniformity of principle in a basic national industry is called for. The best way this could be achieved is to remove the powers of State Governments to impose a tax on the sale and consumption of electrical energy and to vest it in the Union.

"Electricity" is now listed as Item 38 in the Concurrent List (Seventh Schedule to the Constitution) and the concurrent powers of the States in respect of electricity policy will in no way be interfered with if an additional item is listed in the Union List, reading "Taxes on sale purchase or consumption of electrical energy".

Item 39 of the Concurrent List deals with "Newspapers, books and Printing Presses"; nevertheless "Taxes on the sale or purchase of newspapers and on advertisements published therein" finds a place in the Union List (Item 92). If a State taxation on dissemination of news and incidental matters is barred, a taxation on electrical energy—a prime tool of production—should be equally so. At the same time Item 53 from the State List "Taxes on the consumption or sales of electricity" should be deleted.

If for some reason or another this suggestion involving an amendment of the Constitution proves difficult, uniformity could be obtained by the duty being levied by the States on the basis of a fixed percentage of the selling price of electricity. It must be borne in mind, however, that the selling price may in some areas be already high, which postulates that any general percentage rate of tax should be basically low. In any case not higher than the rate applicable upon an essential commodity under parallel Sales Tax laws.

NOTE ON ELECTRICITY DUTY.

Pursuant to the powers vested in the Provinces under the Government of India Act, 1935, and subsequently in the States by the Constitution, certain State Governments are at present levying special duties on the sale or consumption of electrical energy. Conditions obtaining in this regard vary from State to State, and to indicate the vagaries of the various State Governments in the application of the tax, data is attached summarising the position as far as this Federation is aware.

The Electric Supply Industry has been noting with a sense of misgiving the increasing tendency of the State Governments to victimise the electricity consumer. Electricity plays an important part in the development of the nation and in conformity with the Five Year Plan a number of schemes for the extension of electricity to urban and rural areas have been, or are being, sponsored by the Central and various State Governments in consonance with the Centre's proclaimed policy of extending the benefits of power at the cheapest possible cost. In this context a tax on electricity is contradictory.

The Industry's endeavours to combat this taxation have been sustained, and major attention has been directed to the taxation existing in the Bombay State—a State which has been in the forefront in applying this form of taxation.

The attempts of State Governments to tax electricity consumption came in for criticism at the hands of the Power Engineers' Conference which met in New Delhi in February, 1949, under the auspices of the Central Government when the Conference passed the following Resolution:—

"This Conference is of the opinion that electricity being essential for industrial and agricultural production, it is of the utmost importance that its consumption for such purposes be exempted from all forms of direct taxation including sales tax and octroi duties, especially as the cost of generating and distributing electrical energy will be substantially higher in future due to the abnormally increased costs of all plants, materials and constructions."

The passage of time since the introduction of this tax has neither varied nor minimised the fundamental objections to the tax which can be briefly summarised as follows:—

1. The tax is a bar to progress, for by penalising the use of electricity it retards the general application of what is universally regarded, and accepted, as an essential and important element in the modern standard of living.
2. Consequently, it is an impost on the health, eyesight and advancement of the people.
3. The tax is inequitable and it singles out electricity for a heavy and regressive form of taxation.
4. The tax bears most heavily on the man of moderate means and effectively discourages the poor man from availing himself of the manifold benefits which electric light and fans can provide. As applied to industrial consumption, it increases the cost of living by raising industrial costs.

5. The existence of this tax increases the cost of the consumer's installation and thereby the cost of service to consumers using electric refrigerators, cooking, water heating and other appliances in addition to lights and fans because in such cases a separate meter and complete wiring system has to be provided merely for the purpose of metering the lights and fans consumption so that the differing rate of Government Electricity Duty can be assessed.

6. The tax inhibits supply companies from introducing the modern "all-in" type tariff.

When the Indian Constitution was on the anvil an attempt was made by the Federation in a representation to the Constituent Assembly, to have electricity transferred from the Concurrent List to the Union List, so that if at all electrical energy was to be taxed it could be done by the Centre. This could have avoided the vagaries now prevailing in State taxation on electricity. If there was a case for taxation on newspaper advertisements to be transferred to the Union List, as was done, the case for taxation on electrical energy being taken out of the State orbit was at least equally justifiable.

The next stage when the matter was taken up with the Central Government was when the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Bill, 1951, was under consideration by Parliament. The Bill, among other things, listed "electrical energy, except energy intended for domestic use" as an article essential for the life of the community. It was, then, suggested for Government's consideration that the scope of the Bill should be enlarged by stipulating that electrical energy used for all purposes should be declared as being essential for the life of the Community.

When the Select Committee reported on the Bill a recommendation was made to omit electrical energy from the Schedule (listing essential goods) to the Act because the Committee was doubtful whether the expression "goods" in Article 286(3) of the Constitution includes electricity.

When electrical energy was included originally in Item 8 of the Schedule to the Bill there was hope that the vagaries of State taxation on electrical energy would be regularised.

The principle that States should not be given a free hand in taxing electrical energy for industrial consumption having originally been accepted by the Central Government, and only a technical difficulty having prevented Government from giving effect to this, should, it is thought, by itself be a strong argument against State Governments tapping this source of revenue.

In their increasing need to find finances State Governments do not appear to have realised fully the adverse effects of the electricity tax on the future of electrical development as a tool of production and on the standard of living of the individual citizen. Electricity has long ceased to be a luxury (which conception seems to be recognised increasingly) and the removal of the existing tax on electrical energy would be in conformity with the policy of Government to reduce the cost of essential articles.

While the ill-advised taxation on electrical energy for industrial and "domestic" purposes in some States is only a recent development, the impost on electrical energy for lights and fans consumption in homes is a long standing grievance of the Electric Supply Industry and the consuming public. This tax is by its very nature a bar to progress for by penalising the use of electrical energy it retards the general application of what has come to be regarded, and accepted, as an essential and important element in the modern scheme of living.

The general tendency in the rest of the world is to forgo this form of taxation. For instance an Electrical Energy Tax was in force in the U. S. A. against utilities up to 1st November, 1951. This consisted of a 3-1/3 per cent. tax of the total revenue from residential and commercial customers. Industrial consumers were exempt, as also certain other specified groups. The tax was only applied to the investor-owned power companies and correspondingly applied to their consumers. The customers of rural Co-operatives and State and Municipally-owned systems were exempt. When Congress attempted to apply the tax universally there was so much objection from the Co-operatives and Municipals that this taxation was blocked. Congress then decided that in all fairness it should be eliminated from the private companies as well, and this was done.

It will be appropriate to draw specific attention here to the incidence of tax (3-1/3 per cent) which prevailed in the U. S. A. while in Bombay, for example, the duty on lights and fans consumption works out to 66-2/3 per cent. on the energy price, and in the case of industrial consumption to 32-5 per cent.

Eminent Publicists and public men have underlined the importance of electrical energy in the nation's economy. Shri G. L. Mehta, the present Indian Ambassador to U. S. A., and until lately Member, Planning Commission and Chairman, Tariff Commission, remarked in an article (Output May/July, 1952) in the Press that

"there is no doubt that apart from the economic utilisation of power electricity changes intimately and profoundly the way of life of a village or town. It is, in more sense than one, a source of light". At the same time Shri A. D. Gorwala in another article (Output May/July, 1952) expressed in an even more forcible way the role of electricity in a country's development—

"Electricity, it has been said, is civilisation. If you would civilize, in other words, create modern minds capable of dealing with the problem of the modern world, first supply electricity. It is the initial instrument of technological development. Without it the modern outlook cannot grow".

The existing tax on energy, therefore, particularly on industrial consumption, constitutes an impost on an "initial instrument of technological development", whereas it is obvious that tax free electricity (making it cheaper) would engender greater prosperity with corresponding increase in the standard of living, and the consequent raising of tax potential in other directions.

Finally the tax is discriminatory and regressive as it is not, and could not be, applied to mechanical sources of power which are generally less efficient and convenient.

ELECTRICITY DUTY AS APPLIED IN VARIOUS STATES

Bombay.

The Bombay Finance Act, 1932, introduced an Electricity Duty (as a temporary measure) for the first time in Bombay State. The duty was applicable on consumption of energy for lights and fans in residential quarters and office premises.

The rate of duty was $\frac{1}{2}$ anna per unit in respect of all consumption if the total consumption was 13 units and over per month. Consumption under 13 units was exempt. (Observe the guillotine effect at the 12th unit.)

The Finance Act of 1932 was amended in 1938, whereby the duty was enhanced from $\frac{1}{2}$ anna to $\frac{3}{4}$ anna per unit. The exemption on consumption of not more than 13 units was continued.

The Act was again amended in 1939 whereby the total exemption to consumption of not more than 13 units was modified. The scale of taxation (on Lights and Fans only) then prevailing—and which continues to prevail—in the various arcas of the State is indicated in the attached Schedule.

SCHEDULE

(1) The area of supply in which under the terms and conditions of a license granted under section 3 of the Indian Electricity Act, 1910, or any place in any other area in which under section 27 of the said Act a licensee holding any of the licenses mentioned is authorised to supply energy.	(2) For each unit of energy consumed for the use of a cinema house or theatre.	For each unit of energy consumed for any other purpose	
		(3) Where the total consumption per mensem does not exceed 12 units.	(4) Where the total consumption per mensem exceeds 12 units.
(1) The Ahmedabad City Municipality and District Local Board Electric License.	$\frac{3}{4}$ anna per unit.	1 anna per unit.	$1\frac{1}{2}$ anna per unit.
(2) The Surat City Municipality and District Local Board Electric License.	do.	do.	do.
(2A) The Baroda City Municipality License.	do.	do.	do.
(3) The Bombay Suburban Electric License.	do.	$\frac{3}{4}$ anna per unit.	do.
(4) The Poona Electric License.	do.	do.	do.
(5) The Thana Electric License.	do.	1 anna per unit.	do.
(6) The Bhiwandi Electric License.	do.	Nil	$\frac{3}{4}$ anna per unit.
(7) The Bolgaum Electric License.	do.	Nil	do.
(8) The Kalyan Electric License.	do.	1 anna per unit.	$1\frac{1}{2}$ anna per unit.
(9) The Ahmednagar Electric License.	$\frac{1}{2}$ anna per unit.	$\frac{3}{4}$ anna per unit.	$\frac{3}{4}$ anna per unit.
(10) Rander Electric License.	do.	do.	do.
Other areas.	do.	Nil	$\frac{1}{2}$ anna per unit.

Bombay Finance Act, 1932. No. 9326-A(3).—In exercise of the powers conferred by clause (b) in the First Schedule to Part II of the Bombay Finance Act, 1932 (Bom. II of 1932), the Government of Bombay is pleased to prescribe the rates specified in column 2 of the Schedule hereto appended for the lamps of the watts specified in column 1 of the said schedule as the rates at which the electricity duty shall be levied with effect from 1st April, 1939, on the said lamps in respect of all the premises not exempted under the proviso to section 5 of the Second Schedule, when flat rates are charged by the licensee.

SCHEDULE	Annas per mensem.
Every lamp of less than 30 watts	2
Every lamp of 30 watts or more but less than 40	3
Every lamp of 40 watts or more but less than 60	4
Every lamp of 60 watts or more but not exceeding 100	6
and	
For every additional 15 watts or fraction thereof in excess of 100 in any lamp	1

Bombay Finance Act, 1932. No. 9326-A(4).—In exercise of the powers conferred by section 16 of the Bombay Finance Act, 1932 (Bom. II of 1932) the Government of Bombay is pleased to direct that Part V of the said Act shall extend to cities of Surat and Sholapur and all other urban areas in the Province of Bombay.

In exercise of the powers conferred by section 17(c) of the said Act, the Government is further pleased to declare that the areas mentioned in the Schedule shall for the purposes of Part V of the said Act be included in the cities of Bombay, Surat and Sholapur respectively.

SCHEDULE

1. Bombay—The town and Island of Bombay.
2. Surat—The limits of the Municipal Borough of Surat.
3. Sholapur—The limits of the Municipal Borough of Sholapur.

The Act was further amended in 1949 and a duty on all electricity consumed, other than lights and fans, was imposed at $\frac{1}{4}$ anna per 2 units. Lights and fans continued to be taxed at the high rate as before.

On representation from the Industry Government agreed to treat industrial lighting as forming part of industrial consumption charged at the lower rate of $\frac{1}{4}$ anna per 2 units.

The Act was further amended in 1951 whereby the duty on consumption for electrolytic purposes was reduced from $\frac{1}{4}$ anna per two units to $\frac{1}{4}$ anna per 5 units with certain conditions regarding the rates of cost of energy consumed to total cost of production. The ratio set appears, however, to have been unsuitably high (30 per cent.) resulting in the relief being illusory.

The Act at present provides for exemption in respect of supplies to the following—

- (1) (The Crown), save in respect of premises used for residential purposes;
- (2) a railway administration as defined in clause (6) of section (3) of the Indian Railways Act, 1890, save in respect of premises for residential purposes;
- (3) a local authority, save in respect of premises used for residential purposes;
- (4) a tramway company, save in respect of premises used for residential and office purposes;
- (5) a hospital or dispensary which is not maintained for private gain.

The rate of duty in relation to power costs varies, but reaches maxima in the City of Bombay of 66·2/3 per cent. in the case of Lights and Fans consumption, and 32·5 per cent. in the case of industrial consumption.

Bengal.

A duty on electricity was imposed effective from 1st July, 1935.

The rates of duty applicable are—

When the nett charge of the licensee for the supply of energy for the purpose of lights or fans or both does

not exceed 3 annas for each unit of energy consumed as follows, namely:—

In the case of a consumer whose consumption of energy during the month to which the calculation of duty relates—

- | | |
|--|--|
| (i) does not exceed fifteen units | Nil. |
| (ii) exceeds fifteen units but does not exceed fifty units | Six pies for each unit of energy consumed. |
| (iii) exceeds fifty units | One anna for each unit of energy consumed. |

(Observe the guillotine effect at the 15th and 50th units.)

Exemptions—

1. Any Government, save in respect of premises used for residential purposes.
2. A railway administration, save in respect of premises used for residential purposes.
3. A local authority, save in respect of premises used for residential purposes.
4. A tramway company, save in respect of premises used for residential or office purposes.
5. A mine, save in respect of premises used for residential or office purposes.
6. An industrial undertaking, save in respect of premises used for residential or office purposes.
7. A hospital or dispensary which is not maintained for private gain; place of public worship, public burial or burning ground or other place for the disposal of the dead; premises declared by the Provincial Government to be used exclusively for purposes of public charity.
8. Any consumer not using more than fifteen units in any one month.
9. Any consumer, being a landlord, or other person who supplies energy to one-roomed or two-roomed shops or tenements in any one building, in respect of the energy supplied to any such shop or tenement in which not more than fifteen units of energy have been used in any one month.

The rate of duty in relation to total charges for electricity is of the order of 15 per cent.

Uttar Pradesh.

A duty on electrical energy has been imposed effective from 15th January, 1953.

The incidence of duty is 25 per cent. of the rate charged for all consumption with certain exceptions, such as Government premises and the duty is modified if the duty together with the tariff charge exceeds 9 annas per unit.

The incidence of duty in relation to power costs varies from place to place, the lowest level being 9 per cent. and the highest 21.9 per cent.

Madras.

Here the liability to pay the duty is upon the suppliers who may recover it from consumers. (Elsewhere the liability is upon the consumers.)

The duty was imposed in Madras in the year 1939, and the rate of duty at present is $\frac{1}{2}$ anna per unit on all consumption charges at more than 2 annas per unit, except sales to certain privileged consumers, such as the Central Government and Railways.

Licencees are exempt from duty in any month if the total sales of energy effected by them in the previous month, at whatever price, does not exceed 18,666 units. However, if at the end of the financial year the total sales of energy effected by the licensee at whatever price are not less than 200,000 units the licensee is to pay the duty in respect of any month or months comprised in such year in which the sales of energy effected by him did not exceed 18,666 units.

The percentage of duty to the power costs vary from 4.2 per cent. to 12 per cent.

Bihar.

A duty on electricity was imposed on Bihar from 1st October 1948. The rate then was $\frac{1}{2}$ anna per unit on all energy sold except to certain classes of consumers, namely Government, Railway, Municipality, etc. This rate was increased to $\frac{3}{4}$ anna per unit with effect from 1st April 1953.

The percentage of duty collected in relation to power costs ranges from $4\frac{1}{2}$ per cent. to $8\frac{3}{4}$ per cent.

Madhya Pradesh.

An electricity duty was first introduced in Madhya Pradesh in October, 1949, vide the C. P. & Berar Electricity Duty Act.

The rate of duty at present in force is Rs. 0-1-0 per unit of electrical energy sold for lights and fans or any

other appliance connected to a lighting circuit, exclusive of the following classes of consumption for lights and fans, namely:—

- (a) Consumption for street lighting or consumption in market place or any other places of public resort, maintained by a local authority.
- (b) Consumption for indicating lamps, pilot lamps and signal circuits using lamps for the purpose.
- (c) Consumption for purposes of the State Government, Union Government and Railways.
- (d) Consumption for industrial purposes, except energy consumed in the residence of an employee of an industrial concern.
- (e) Any other class of consumption as may be specified by the State Government.

The percentage of duty collected to total power costs works out between 11 and 12 per cent.

As far as this Federation is aware, a tax on electrical energy exists in no other State.

PART VI.—LOCAL TAXATION.

In this section, the Federation is primarily concerned with octroi and terminal taxes on materials used by electric supply undertakings (in one case octroi is even being sought to be imposed on electrical energy itself), and with the basis of assessment of properties employed in Electric service. Some general remarks are also offered on the recommendations of the Local Finance Enquiry Committee. These points can be conveniently dealt with under, say, Questions 190, 195 (a), 201, 204, 210 and 227.

Question 190.—Is there failure to prevent the devolution of unsuitable taxes? In other words, are taxes allowed to be levied which are manifestly unsuitable for levy by the particular category of local bodies? Please give instances.

The indiscriminate levy of octroi by Local Authorities has actually led to one Municipality to seek to impose an octroi duty on electrical energy itself. Such an impost is manifestly unsuitable. For one thing, it is doubtful whether electrical energy can at all be considered 'goods' in the ordinary sense, and for another such a form of octroi would have all-India repercussions, and result in greater power costs. A Court case is now pending. A definite embargo should be placed on such octroi being levied.

Question 195 (a).—Is there in your opinion defective co-ordination—fiscal, administrative or other—between particular local taxes and allied State or Central taxes? Please give instances and point out the nature and order of the detrimental effect, if any, on the public or on trade, industry, etc. What remedies would you suggest?

Although an Electricity Duty is already in being in many States, the Electric Supply Undertakings are also subject to levy of octroi on materials used by them and which are imported into their area. With the end product already being subject to a heavy Electricity Duty it is only appropriate that the Industry should obtain exemption from other forms of imports.

The octroi is particularly onerous when applied to basic commodities like coal and fuel oil and also Mains materials used for distribution of energy. It is therefore for consideration that, at least, such basic materials as fuel should be out of bounds of Local Authorities in levying octroi.

Question 201.—If the question of valuation was confined to the levy of urban immovable property tax by States and general property tax by local bodies what basis would you adopt: capital value or annual rental value? Do you agree with the recommendation of the Local Finance Enquiry Committee that "there should be no change from the well-tried basis of rent to the more or less uncertain basis of capital value", but that where "municipalities are actually adopting capital value as the basis and there is no complaint, that basis may continue"?

While the question raises discussion on the merits and demerits of municipal assessment on rental value versus capital value, one Local Authority has endeavoured to assess the local Electric Supply Company on the basis of the profits earned. The method used is known in England as the "profits method". The legality of this in India is being contested in Court. In any event this method of assessment appears irrational as it puts a premium on inefficiency, and at least on this score should be condemned outright.

It is submitted that the proper basis of assessment is always on rental value.

Question 204.—Should property tax be progressive? If so, how and to what extent?

Property tax should not be progressive. For electric supply concerns this would mean that the more they expanded their service the greater the incidence of tax, i.e., a tax on progress.

Question 210.—Does your examination lead to the conclusion that both octroi and terminal taxes are unsuitable as forms of local taxation and should, therefore be abolished? If so, what substitutes would you recommend? Do you consider the suggestion that local bodies should be allowed to levy surcharges on sales tax feasible and desirable?

With the scope and functions of Local Authorities becoming increasingly wider, there would seem to be need for the existing system of municipal finances to be made more flexible so as to meet the needs of progressive communities. The modern tendency of Local Authorities' finances is towards simplification and unification. This would involve the narrowing of the taxes levied by the Local Authorities and the consequent increase in their dependence on financial aid from Government. The method of augmenting the financial resources of Local Authorities by grants-in-aid has certain advantages over assigned revenues, as under this system it would be possible to adjust the grant of financial assistance suited to the needs of each Local Authority and also it would be possible to exert an overall control over their activities, thus preventing abuse. This method of financing could be buttressed by a share in the taxes of State Governments.

Octroi Duty is now the backbone of Local Authority finance. This form of duty, however, has been very widely criticised as constituting a serious inconvenience and interference to trade and industry. The demand for the abolition of this form of taxation is therefore widespread. This form of taxation has ceased to be in operation in other progressive countries and public opinion in this country, too, is in favour of its abolition as being an antiquated and cumbersome levy.

It is pertinent here to refer to Article 301 of the Constitution Act. This lays down that "trade, commerce and intercourse throughout the territory of India shall be free". Continuance of Octroi duties or terminal taxes constitutes interference with this freedom and thus nullifies the intentions of the framers of the Constitution, unless held *ultra vires* of the Constitution.

If this form of taxation is objectionable as applied to Industry generally, its application to the Electric Supply Industry is more objectionable. It is the accepted policy of Government to make available a prime tool of production like electrical energy at as cheap a rate as possible and the Industry is no less eager to achieve this.

Question 227.—Have you any comments, not already covered by your answers, to make on the recommendations of the Local Finance Enquiry Committee in so far as they are relevant to local taxation?

The Local Finance Enquiry Committee was primarily constituted with a view to finding the wherewithal to meet the growing obligations of the Local Authorities. The majority of the Committee have, therefore, interpreted their major task as one of discovering sources of income to meet the pressing needs of Local Authorities. If, with this background, the report is to be judged, the Committee have produced a comprehensive document. In doing so, however, they have not given adequate consideration to the harm the ever widening tentacles of octroi is doing in strengthening a barrier of free trade long since abolished in most civilized countries.

There can be no two opinions about the need for securing substantial additions to local finance, but whether some of the methods suggested by the Committee are best to meet this is a matter for doubt.

Among the sources of revenue recommended by the Local Finance Enquiry Committee for relegation to Local Authorities, specific reference must be made to taxes on the consumption of electricity (State List—Item 53).

The proposed transfer of taxes on the consumption or sale of electricity to Local Bodies is anathema to the Electric Supply Industry as if this, originally temporary, form of impost on the basic and essential public service of electric supply is assigned to the Local Authorities it is likely to be perpetuated, and moreover in widespread and widely differing forms. This would do great disservice to users of a prime tool of production—which electricity is—and be likely to cause migration of industry. Electricity Duty when levied by State Governments is bad enough, and if this source of revenue is to be transferred to Local Authorities, infinitely more harm will result to the fabric of a primary industry in the country.

The Local Finance Enquiry Committee's Report makes an interesting reference to the future of Local Authorities in the field of electric supply in the context of the Electricity (Supply) Act.

Under the provisions of the Indian Electricity Act, 1910, the first option to purchase of a licensee's undertaking either on revocation of license or at the expiry of its period rested, generally, with the Local Authority. This right was transferred outright to the State Electricity Boards, vide Section 71 of the Electricity (Supply) Act, 1948. The overall effect of this is that hereafter the electric supply undertakings will no longer auto-

matically come into the possession of Local Authorities. The Committee have expressed the view that this limitation should not apply in regard to Local Authorities.

It is felt that the Local Finance Enquiry Committee in commenting upon the question have not had the benefit of the same intimate knowledge of electric supply activities and problems, as had the Central Government when they made the considered change in the law under Section 71 of the 1948 Act. Any suggestion to revert the broad principles laid down in the Electricity (Supply) Act in favour of Local Authorities could only be with a view to enabling the latter to make greater profits out of Electric Supply than could the erstwhile owners, whose profits were controlled by the law. Since municipal profits are not so controlled this would result in giving blessing to higher charges for electricity, and should be resisted.

(Supplementary information by letter, dated 30th September 1953.)

Electricity duty.

Please refer to this Federation's Memorandum, dated 18th September, replying to certain parts of the Taxation Enquiry Commission's questionnaire.

The Federation has since been advised that there exists an Electricity Duty in the case of one Licensee in PEPSU (the one operating in Bhatinda) in the form of a Royalty under his license of 3 pies per unit on Lights and Fans consumption and 3 per cent. of income from industrial and bulk load. Such royalty being a legacy from the days when the Electric License was given by a Princely State is an anachronism, and whatever is decided in the case of electricity duties elsewhere should be applicable in lieu of royalty in this case also.

(Supplementary information by letter, dated 19th November 1953.)

In connection with the Federation's Memorandum to the Commission, I have been endeavouring to ascertain the practice in vogue in other countries regarding duty on electricity. I enclose, for your information, an extract from a letter, dated 6th November received from the Electricity Supply Association of Australia.

"There is no direct tax in any State of the Commonwealth of Australia on the sale of electricity nor has there been a suggestion to my knowledge at any time that there should be.

"In Australia electricity supply is mainly in the hands of Governmental or Municipal (local government) Authorities, but in the more remote areas supply is frequently given under statutory authority by private enterprise, but this represents a very minor proportion only.

"In their operations, Governmental and Municipal electricity supply authorities are exempt from income taxation, they do not pay municipal rates, they are exempt from payment of sales tax on the purchase of materials normally subject to sales tax. They are, however, subject to the general provisions of our Customs Tariffs in regard to imported materials, although not all plant and materials imported are dutiable, and they also pay to the Commonwealth in harmony with all employers whose weekly pay-roll exceeds £80 per week, a pay-roll tax of 2½ per cent."

(Supplementary information by letter, dated 30th November 1953.)

Electricity Duty.

Further to my letter of 19th November reporting on the practice in Australia over taxation on electrical energy, I understand from the Hydro-Electric Power Commission of Ontario that electrical energy as such is not taxed in any form within that Province. The Commission are however required to pay to the affected Dominion or Provincial controlling authority rentals for the use of water for the operation of their hydraulic Generating Stations, based on kilowatts of production.

(Supplementary information by letter, dated 19th April 1954.)

Deferred Tax Reserve.

In this Federation's Memorandum to your Commission the problem of deferred tax liability which afflicts the Electric Supply Industry was specially highlighted and this was fully gone into when representatives from the Federation gave evidence before the Commission on 9th February 1954.

A similar problem in the United States has been dealt with by the U. S. Federal Power Commission in favour of the Electric Supply Industry there, and for your information I enclose an extract from the Public Utilities Fortnightly of 4th March reporting the decision of the Federal Power Commission.

It is hoped that this report may be of assistance to your Commission in making their recommendations to the Government of India.

(Extract from Public Utilities Fortnightly of 4th March, 1954.)

Federal Power Commission Rules on Rate Consequences of Accelerated Amortization.

The Federal Power Commission recently expressed its views on the treatment of accelerated amortization in rate cases. The accounting aspects of the situation, the commission said, would be treated in a later proceeding.

No Rate Reduction.—One of the principal matters considered was whether a rate reduction should be required during the amortization period. The Commission ruled rates should not be reduced during the 5-year period in which the defense facilities would be written off, notwithstanding the substantial tax savings experienced, because of the abnormal depreciation. Congress, the Commission said, did not forgive but merely deferred the taxes which would have become due during the 5-year period. Assuming that the tax rate will not change there would be no ultimate tax savings to the utility.

Interest Free Loan.—Any other view, the Commission continued, would result in a cash donation to the particular persons who happened to be customers during the 5-year period. The effect of the tax deferred was described as a "grant by our government to a certificate holder of an interest-free loan".

The Commission did not consider that it had the authority to question the wisdom of the government

agency which awarded the emergency certificate or the right to speculate on whether there would be a reduction in the income tax rate. The annual depreciation charge for rate making would be related to the service life of the property notwithstanding the fact that a different basis would be used for tax purposes.

Return on Tax-Savings.—Finally, the Commission disposed of the question as to whether a return should be allowed on the income tax savings accruing during the 5-year period. In answering this question in the affirmative, the Commission overruled a contention that these savings are customer contributions and said that as long as the funds are invested in used and useful plant, a return should be allowed.

A strong dissenting opinion by Commissioner Dot challenged the majority's reasoning on the deferred taxes. He contended that the accelerated amortization should be recognised in fixing rates. The tax savings, he said, "has none of the characteristics of a loan, due date, amount certain, etc.".

The Commissioner gave his answer to the question in these words:

To me, the problem would best be handled by the allowance of accelerated depreciation expense and the deduction of the resulting depreciation reserve from the rate base in the fixing of just and reasonable rates.

Re. Treatment of Federal Income Taxes, Docket No. R-126, Opinion No. 264, December 4, 1953.

Federation of Motor Transport Associations, Bombay.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

TAXES ON MOTOR AND OTHER VEHICLES.

Question No. 168.—Taking into account (a) the several taxes, Central, State and Local, which affect motor transport directly and business, trade, etc., indirectly, (b) the variation in some of these taxes from region to region and between different categories of vehicles, and (c) the relative financial needs of the different taxing authorities, both generally and, in particular, for the maintenance, improvement and extension of roads, what changes, if any, would you introduce in the present system of motor vehicle taxation?

Taxes on motor transport vehicles are not fundamentally a tax on a commodity or article, but are rather a tax on transport, and thus constitute a levy on the goods, commodities or persons carried. The cost of transport including the taxes levied on it thus directly affect the cost of living, the health, the education and well being of everyone of the nation's millions of citizens.

We also feel that the present inadequacy of transport is seriously curtailing the nation's development and preventing the raising of living standards. In many regions, roads or other transport are non-existent or so poor that transportation costs are prohibitive. Production must then be on a very limited sectional scale which naturally cuts down on the number of consumers. Millions of people living in those parts of the continent exist in closed circles barely producing what they themselves can consume and are prevented from extending their field of operations. Their production of necessity must be matched to their wants even though the local productive facilities be unsuitable. They are prevented from utilising their productive facilities most efficiently due to lack of transport to move it to consuming areas. Thus we have the fishing industry in India practically undeveloped due to the restricted market which can be served from the country's coast line, and fruit in Northern India being left to rot or used as fertilizer as cheap and efficient transport is not available for it to reach the other parts of India at a reasonable cost.

We, therefore, urge that it is essential that all transport including motor transport and the taxes thereon be placed under the direct control of the Central Government. The present policy of allowing motor transport to be taxed not only by the Centre, but also the States, the Local Boards and Municipalities should be changed, and only taxation by the Centre permitted. All means of transport be it rail, air, water or road are equally important and essential to the country's economy and the welfare of the people, and only the highest authority, viz., the Central Government should be empowered to co-ordinate, control, develop and levy taxes on it.

Railways, airlines and shipping companies are already so run, and state or local taxes are not leviable on them. Port Trusts and airfields do make charges, but these are only for facilities provided and do not constitute taxation in any concept. We maintain that motor

transport being equally essential should be equally treated.

What degree of uniformity do your suggestions involve?

As mentioned previously we feel that complete uniformity is essential and in our opinion this can only be achieved by all taxation authority being concentrated in the Central Government.

Instead of several taxes by different authorities, a consolidated tax has been suggested; do you consider this feasible?

We believe that a consolidated tax under the Central Government would present no unusual difficulties. The various States and if necessary Municipalities could be called on to act as agents of the Central Government in tax collection particularly if as we suggest all proceeds from motor vehicle taxation be statutorily allocated.

How would you apportion the proceeds among the different authorities concerned?

We recommend that the proceeds of motor vehicle taxation be allocated under only two heads:

(a) A fair contribution, on the same basis as other essential industries, to general revenues.

From such general revenues, towns and municipalities may when necessary be given advances to compensate them for loss of revenue from municipal wheel taxes, octroi, and terminal taxes which we strongly recommend be eliminated. In this respect we agree completely with the findings and recommendations of the M.V.T.E.C.

(b) A revenue sufficient and specifically allocated to the development and expansion of the motor transport industry itself through the construction and maintenance of an adequate road system. Inland transport is grossly inadequate for the country's needs and expansion of the railway network does not seem a practical solution as even the present trackage and facilities are not being used to the fullest extent due to lack of rolling stock, and modernization of their present trackage and facilities. Due to the capital investment required this will take a considerable period of time. Due to the greater flexibility and relatively lighter capital requirements motor transport can be rapidly expanded.

Generally speaking we agree with the recommendations of the M.V.T.E.C. regarding actual taxes to be levied.

CENTRAL TAXES.

1. Customs duty on motor spirit at 30 per cent. ad valorem to remain as at present.

(NOTE.—This to be credited to general revenues.)

2. We recommend that the Central Excise on motor spirit be reduced by annas two per gallon which is urgently needed to reduce operating costs and thus assist the expansion of motor transport. In our opinion the expansion of the industry could better be encouraged by lowering the price of vehicles through a lowering of customs duty on motor vehicles, spare parts and accessories, but Government's recently announced decision on the report of the Tariff Commission on the automobile industry apparently precludes this, so a reduction in running costs is the only alternative.

3. We recommend that Central Excise on tyres be revised as follows:

(a) *Cycle tyres and tubes.*—As cycles provide the so-called poor man's transport, we recommend that the present excise be reduced from 15 per cent. to a nominal 5 per cent.

(b) *Passenger tyres and tubes.*—We agree that these remain as at present at 30 per cent.

(c) *Giant tyres and tubes.*—To afford a reduction in running costs and thus encourage the expansion of the industry, we recommend that the Excise be reduced from the present rate of 30 per cent. to 20 per cent., which will also more nearly conform with the Customs duty levied on railway equipment.

(d) (i) Farm Tractor and Implement tyres and tubes,

(ii) Earthmoving and Off-the-Road tyres and tubes,

(iii) Animal Drawn Vehicle, Hand Cart and Industrial tyres and tubes,

(iv) Aero tyres and tubes.

We recommend that no Excise be levied, as with the exception of Animal Drawn Vehicle and Hand Cart tyres and tubes which it is in the interest of the country to encourage the use of, the balance are not customarily used on roads, and are used in projects essential to the country's development.

(e) We recommend that all tyres supplied to manufacturers for fitment on new vehicles be exempt from Excise Tax as being a practical way to lower present vehicle prices and so encourage their purchase and use. As all tyres are identifiable by serial numbers and supplies are made to vehicle manufacturers direct from the four Tyre Companies only, this should be very easy to control.

(f) *Retreaded Tyres.*—During the past five years, the progress of retreading tyres has greatly increased which we think constitutes a desirable saving in materials. At the same time there is a wide disparity between the price of a new tyre and the price of a retreaded tyre which we recommend be in some measure equalized by also levying an excise duty on retreaded passenger tyres of 10 per cent. and in the case of giant tyres 10 per cent., this tax to be levied on the then current price of a new tyre as this is a constant value. As there are comparatively few retreading shops in operation, and as they are practically all located in large centres, collection of this additional tax should not entail much difficulty.

(g) We recommend all Excise on new and retreaded tyres and tubes be credited to a non-lapsing Road Fund at the Centre.

4. In our opinion Customs duty and Excise on motor vehicles, parts and accessories may be apportioned to central revenues.

STATE TAXES.

While the M.V.T.E.C. recommended two State taxes on motor transport, we recommend that these should both be levied by the Centre.

1. We agree with the recommendation of the M.V.T.E.C. that the States' fuel tax should be fixed at present at 6 annas per gallon on motor spirit to replace all existing sales taxes on motor spirit in the various states.

2. In view of motor transport being actually a service, we feel that the States' sales tax on trucks and buses should be eliminated. The State's sales tax on motor cycles, motor cycle combinations and motor cars for private use may remain, but the rate should be set on the same level as for other non-luxury goods.

3. We recommend that the motor vehicle tax suggested by the M.V.T.E.C. be adopted, but as with all other taxes on motor transport it should be determined

and collected by the Central Government or the States acting as agents of the Central Government.

Class of Motor Vehicles	(Maximum) yearly tax	Remarks
<i>A.—Vehicles using Motor spirit as fuel only.</i>		
1. Motor cycles	Rs. 18 flat rate	Note.—See B below for taxation of motor vehicles using other fuels.
2. Motor cycle combinations (for private use).	Rs. 24 flat rate	
3. Motor cars* (Private motor vehicles).	Rs. 15 for every 500 lbs. unladen weight or part thereof upto 2,500 lbs. plus Rs. 25 for every additional 500 lbs. unladen weight or part thereof, beyond 2,500 lbs.	*If licensed for use, for hire or reward these are to be taxed under items 4 and 5.
4. Goods vehicles (Public and Private).	Upto 1,000 lbs. licensed laden weight Rs. 100, 1,000 lbs. to 4,000 lbs. Rs. 100 plus Rs. 20 for every additional 500 lbs. or part thereof. Tax on 4,000 lbs. Rs. 220, 4,000 lbs. to 8,000 lbs. Rs. 220 plus Rs. 25 for every additional 500 lbs. or part thereof. Tax on 8,000 lbs. Rs. 420, 8,000 lbs. to 18,000 lbs. Rs. 420 plus Rs. 30 for every additional 500 lbs. or part thereof. Tax on 18,000 lbs. Rs. 1,020, 18,000 lbs. and over Rs. 1,020 plus Rs. 100 for every additional 500 lbs. or part thereof.	
5. Public Passenger vehicle.	Licensed capacity including standing passengers but excluding driver and conductor if shown in the licence:	
(i) cabs (contract carriages).	3 to 4 persons 3 wheelers Rs 200 4 wheelers Rs 300	Includes tonga taxis & light cars not over 2,500 lbs. unladen weight.
	4 to 8 persons : Rs. 400 plus Rs. 50 for every additional beyond 8. Tax for 8 seater cab Rs. 600.	Includes 4 seaters over 2,500 lbs. unladen weight.
(ii) Buses (Stage carriages)	8 to 26 persons Rs. 600 plus Rs. 80 for every additional person beyond 8. Tax for 26 seater bus Rs. 2,040. 26 to 32 persons Rs. 2,040 plus Rs. 60 for every additional person beyond 26. Tax for 32 seater bus Rs. 2,400. 32 persons and above Rs. 2,400 plus Rs. 40 for every additional person beyond 32.	

Class of Motor Vehicles.	(Maximum yearly tax.	Remarks.
	<i>B.—Vehicles using fuels other than Motor spirit</i>	
1. Motor cycle	No surcharge	
2. Motor cycle combinations	" "	
3. Motor cars	" "	
4. Goods vehicle (Public and Private carriers).	Taxes as in A, plus a surcharge of Rs. 500 per annum.	
5. Passenger vehicles:		
(i) Cabs	No surcharge.	
(ii) Buses (Stage carriages).	Taxes as in A, plus a surcharge of Rs. 800 per annum.	

We recommend that the Fuel Tax of 6 annas a gallon and the motor vehicle tax should be paid into the various States Road Funds which in our opinion should be made non-lapsible.

LOCAL TAXES.

We heartily concur with the recommendations of the M.V.T.E.C. that all local, octroi terminal and other local taxes be abolished. They are completely inconsistent, irrational and definitely harmful to the free flow of trade. The delays caused to commercial traffic at octroi posts are even more harmful than the taxes themselves, evasions are common and the cost of collection high.

Although their development has not yet started in India, we believe the principal behind the construction of toll roads and toll bridges should be recognised, and we would recommend that a standard contract be drawn up governing such construction and limiting the toll charges to investment recovery, necessary expenses, and a reasonable and somewhat attractive return of say 6 per cent. on the invested capital.

Question No. 169.—To what extent and in what manner, in your view, should the proceeds from motor vehicles taxation be earmarked for road maintenance and development.

We have in our reply to Question 163 made suggestions as to the apportionment of motor vehicle transport tax proceeds among the different authorities concerned. In our opinion, all proceeds except the contributions to Central revenues from customs duty on petrol and customs duty and excise on motor vehicles, parts and accessories excluding excise on tyres and tubes should be specifically earmarked for road maintenance and development. Non-lapsing road funds should be created in each of the various states and at the Centre. To administer and allocate these funds, to control motor

transport, generally formulate standards and provide research, a central board should be set up comparable to the Bureau of Public Roads in the U.S.A. and the Railway Board in India to be assisted by a Transport Advisory Board comprising of business, transport and producers' interests. The Roads Organisation of the Ministry of Transport should be transferred to this Board and function with it.

We may add that in our opinion the construction of new roads, as with construction of railway lines and port trusts cannot adequately be financed out of revenue but should if possible be financed out of road loans.

Question No. 170.—Have you any specific comments to make on the main recommendations of the Motor Vehicles Taxation Enquiry Committee, 1950?

1. We agree that a further amount of $4\frac{1}{2}$ annas per gallon in addition to the present $2\frac{1}{2}$ annas per gallon out of the customs and excise duty on motor spirit should be credited to non-lapsible road funds.

2. We agree with the principle that motor spirit prices should be the same throughout India but we feel that this levelling should be done by the Oil Companies themselves rather than by the levying of a "transport cess" of $1\frac{1}{2}$ annas per gallon on motor spirit by the Centre, with these proceeds being used to pay the cost of transportation. We believe that the Oil Companies could accomplish this most efficiently and at least cost by incorporating the transport charges into their normal distributing expenses, and they should be asked to do this and be permitted to adjust their prices to provide for the additional cost.

Question No. 171.—Have you any suggestion to make regarding the extension of taxation to, or increase of present taxation on, users of roads other than motor vehicles?

1. We recommend that taxation be extended to Animal Drawn Vehicles as they use roads extensively and bullock carts in particular are responsible for much road damage. We agree with the recommendations of the M.V.T.E.C. that carts plying in or near towns should be reasonably taxed, and we consider that Rs. 120 per year could be entirely justified. The use of rubber tyres on carts should be encouraged by a rebate on this taxation and we would recommend a rebate in amount of Rs. 84 lowering the tax on a rubber tyred cart to Rs. 36 per year.

2. We also agree with the M.V.T.E.C. that cultivators' carts should not be taxed, but a road cess of one anna in the rupee on land revenue should be imposed for road use and availability.

3. We would recommend that the taxing authorities on animal drawn vehicles be the towns and municipalities and that the proceeds should be paid into non-lapsing road funds.

Indian Banks Association.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

Question No. 69, read with Questions 18 and 33.

Reply.—Under the recently amended Section 49D, banking profits of foreign branches will be liable to the higher of the two taxes payable in the foreign country concerned and in India. If there is no income-tax in the foreign country concerned, Indian tax will be payable in full. This amendment, however, does not go far enough to encourage banks to develop their overseas banking business. Foreign profits of Indian banking companies ought to be fully exempt from the Indian tax with a view to encouraging them to establish branches abroad, as this will enable them to obtain foreign capital for financing new industries in this Country. In this connection, it may be pointed out that banks stand on a different footing from other businesses having foreign branches, as banks deal in money and their stock-in-trade is money itself, which provides capital for all businesses. At this juncture, when it is believed that India itself has not money enough to provide for all its needs and schemes for betterment of conditions of the masses, every encouragement should be given to banks to establish overseas branches, which would increase their resources and enable them to lend money to large and small-scale industries. Establishing overseas branches is a costly business and unless there is some inducement to go in for them, most banking companies may not venture to extend their business outside this country.

Question No. 82(a), read with Questions 15, 86 and 99.

Reply.—Banks are experiencing a very difficult time at present. With the Industrial Tribunals on the one hand, the inquisitorial methods of the Income-tax Department on the other and the diminishing sense of discipline and devotion to duty among the staff in addition, the Management has to waste every day a good

deal of its time on fruitless, unremunerative work. There are cases in which Income-tax assessment proceedings of public banking companies have been dragged on for nearly two years and assessments for four or five years remain undisposed of. This enormous delay in the completion of a bank's assessment is unfair and causes hardship as, unlike other assesseees, large banking companies, which support Government by holding crores and crores of rupees worth of Government of India Loans, State Loans and loans issued by public bodies, pay, at source, while drawing interest on these loans, lakhs and lakhs of rupees by way of income-tax and these advance payments which may amount to over 50 lakhs in the case of a large banking company, need final adjustment as early as possible. It is very necessary to complete the assessments of public banking companies, as far as possible, within the assessment year concerned, because with a very nearly 50 per cent. income-taxation on their profits, these companies ought to be in a position to know their exact state of affairs as early as possible. This delay in assessment results from the unnecessary, inquisitorial methods adopted by the assessing officers who ought to be instructed to rely on duly audited accounts of public banking companies without wasting time on requisitions for a list of hundreds or thousands of persons whose debts have been written off, with all details about the circumstances in which the loans were granted and written off. Big banks have a large number of branches and years can be easily wasted and are wasted, in fact, in calling for this and similar kinds of information, which has to be collected from the branches concerned. Details of expenses of all kinds, such as those for opening new branches, are called for and time is wasted on the principle of requiring proofs for everything. Strict instructions ought to be issued to assessing officers to deal with assessments of public banking companies as

expeditiously as possible, accepting their returns of income and calling for only such information as is absolutely necessary. There can be no reason to doubt writing off of bad debts by such companies and to waste time in calling for details of all kinds. With an advance deduction of tax at source of about 50 lakhs, if assessments for four years are kept pending, two crores of profits are locked up and, especially in adverse times, when losses are suffered, big banks are financially badly hit, if such large amounts are kept back from them for such long periods. Unfortunately, it is generally when losses are suffered that assessment proceedings are allowed to drag on. The Income-tax Officers ought to be instructed to make use of Section 23(1) of the Income-tax Act as far as possible in assessing banking companies, barring exceptional cases.

Attention is also invited to the fact that the Income-tax Officers have been allowing bad debts only after calling for elaborate proof that they are irrecoverable and very often compel banks to institute court proceedings and incur avoidable expenses to prove to the Income-tax Officers that the debts in fact have been irrecoverable, even where the banks are satisfied that the borrowers have absolutely no means to pay and that incurring further court expenses would mean throwing away good money after bad.

Attention is invited to the special provisions of the Income-tax laws of the United States of America for Banking Institutions, with the object of encouraging them to build up rapidly special reserves to meet all emergencies and particularly losses which arise on a large scale in the case of such national calamities as befooled India in 1946 and 1947 during the pre-partition and ante-partition periods. The communal riots in those days meant very widespread destruction of property, on the security of which Banks had advanced large sums of money for trade purposes, in the course of their ordinary banking business. Several Banks sustained tremendous losses on this account to the tune of several crores of rupees. Again, only a few months ago, when the Government raised through the Reserve Bank the Bank Rate from 3 to 3½ per cent. and, in consequence, prices of Government securities slumped precipitously overnight, Banks, especially those which had a very large holding of several crores of rupees in the 3 per cent. Government Conversion Loan, incurred colossal losses to the tune of crores of rupees. Banking institutions everywhere and more particularly in this country, are subject to such periodic waves of heavy losses. Even the admittedly prosperous and economically most advanced United States of America was not free from such mishaps to the highly organised Banking system in that country and about five years ago, as a result of repeated representations made by Banking institutions there to the Government, special reserves to meet bad debts arising in such emergencies were by law made allowable as an item of expenditure for Income-tax purposes.

The United States of America Federal Income-Tax Law since December 1947 allows banks to build up a special reserve for bad debts allowable for income-tax purposes as under:—

The average percentage of bad debts suffered during the accounting year and 19 preceding years to the average of loans advanced during the said period of 20 years is to be taken and special reserves to the extent of that percentage on the loans outstanding at the end of the accounting year is to be allowed as a bad debt reserve. Thus, if the accounting year is say 1950, and the percentage of bad debts suffered to the average of loans for the years 1931 to 1950 is say 1 per cent., the reserve permissible for 1950 on outstanding loans on 31st December of say 200 million dollars, would be two million dollars. This allowance is subject to a ceiling of three times the percentage arrived at as above on the year end loans. Thus, if for the three years 1950, 51 and 52 the reserves allowed for income-tax purposes totalled to 7½ million dollars and if the percentage arrived at for 1952 is 1 per cent. and outstanding loans on 31st December 1952 are say 230 million dollars, the ceiling would be 6,900,000 dollars and if the total reserves up to and including 1951 come to 5,000,000 dollars after deducting bad debts actually suffered, only 1,900,000 dollars and not 2,300,000 dollars would be permissible. All bad debts suffered are to be debited to the said reserve.

In our Income-tax Act, only bad and doubtful debts actually written off as irrecoverable are permissible and banks have no incentive and encouragement to lay by anything for a rainy day and when faced with heavy liabilities such as those that occurred in 1946-47 and in 1951, as explained above, there is all likelihood of a crash involving financial ruin to thousands of depositors and shareholders. When such an advanced country like the U.S.A. thinks it essential to make a special provision in its Income-tax Law, viz., the Internal Revenue Code, to encourage Banking institutions there to be prepared to meet such contingencies, for a country like India, where banking failures have been many, there is no necessity to make out a case specially for a similar

change in its Income-tax Law. The point to bear in mind in this connection is that there is, really speaking, no sacrifice of Government revenue, the collection of which is merely postponed for a time. Just as there are advance payments of Income-tax, this is merely an advance allowance for anticipated losses on account of bad debts, but its effect on banking business will be most salubrious and will, at times, save many banks and their depositors, creditors and shareholders from ruin.

The U.S.A. provisions need not be adopted here *in toto* and they may be simplified by cutting down the period of 20 years to 10 or the number of years a bank has been already in existence, if it is less than 10. The ceiling and the percentage as fixed in the U.S.A., however, seem reasonable and suitable for this country also. A necessary additional provision will be to allow a Bank to claim the actual loss suffered in a year in case it exceeds the available reserve to the extent of the excess over the reserve already allowed.

It may be noted that the percentage and the ceiling will not be constant but will vary each year and will have to be computed and fixed at the time of each assessment.

The following matter also, in our opinion, deserves the attention of the Commission. Banks are treated as dealers in shares and securities under the Privy Council decision in the case of the Punjab Co-operative Bank Ltd. A very large amount of money deposited with banks is held by them invested in Government of India and other securities as part of their stock-in-trade and interest and other profit earned by them by dealing in them is their business profit. Recently, however, the Calcutta High Court has, in the case of the United Commercial Bank Ltd., held that the gross receipts of banks by way of interest on securities is to be treated as their income taxable under Section 8 of the Income-tax Act, distinct from their other business income and that any business loss which is carried forward, cannot be set off against the said income from interest on securities. This decision most adversely affects all banks and if the law requires amendment, it should be amended so as to allow interest on securities earned by dealers in securities to be treated as business income as is the case in U.K. (*vide* the recent decision of the King's Bench Division in the case of Owen (Inspector of Taxes) vs. Sassoon). It is of paramount importance that banks should support Government by investing in Government securities a very substantial part of the money at their disposal and nothing should be done to discourage this practice in the least.

On p. 44 of the Instructions in the Income-tax Manual, 10th Edition, under Section 8, instructions are given by Government to the effect that no part of interest paid by banks in respect of borrowed money should be disallowed on any such ground that a part thereof has been invested in tax-free securities. The above decision of the Calcutta High Court further lays down, contrary to the above instructions, that interest payable by a bank in respect of funds invested in tax-free securities is not to be allowed. It is, therefore, necessary to see that orders are issued again to ensure that the existing practice is not interfered with.

Questions 1(b) and 101.

Reply.—One of the objectives of a sound taxing policy ought to be encouragement of incentives to work, to save and to invest. Banking companies are dependent substantially on the incentive to save and invest. Unfortunately, the present taxing policy tends to discourage, instead of encouraging, incentives to save and invest as well as to work. The very high rates of income-tax do not leave any substantial savings with those who have the best opportunities and means to save. The present era of high rates of income-taxation started about 12 years ago and its effects are gradually now beginning to show themselves. One effect has been a substantial fall in deposits of banks. It is to be feared that the proposed levy of an Estate Duty will worsen the situation and that in about 10 or 15 years more, the high direct taxation of incomes, coupled with disappearance of past savings through the levy of the Estate Duty, will leave with honest persons hardly anything to save and invest. In our opinion, the levy of income-taxation at anything over 50 per cent. at the most tends to destroy the incentives to save and invest. We are afraid that the combined effect of high income-taxation and Estate Duty will be the drying up of the source of revenue of Government itself in 15 or 20 years more. The banking community would most welcome moderation in the rates of income taxation and of Estate Duty, as its stock-in-trade depends a good deal on incentives to save and invest.

The present taxation policy tends to destroy also the incentive to work. As far as human nature is concerned, the major incentive to work is gain. If from a rupee earned, 13½ annas are taken away by Government, few would care to run the risk of earning 2½ annas only, coupled with the danger of losing a rupee.

Indian Banks Association's Note on the necessity of giving tax concessions to banking companies on account of their special position.

In its replies to some questions contained in the questionnaire of the Taxation Enquiry Commission, the Indian Banks Association suggested that certain tax concessions might be granted to banking companies. At the oral evidence given by the representatives of the Association before the Commission on 26th March 1954, a member of the Commission expressed the view that the tax concessions demanded by the Association for banking companies, if granted to them, would have to be extended to all other joint-stock companies, unless the banking companies could show that they held a special position, which was not held by other joint-stock companies and which justified the grant of tax concessions to banking companies only. The representatives of the Association stated that banking companies did hold a special position. Thereupon, the member of the Commission requested that a note explaining the special position might be submitted to the Commission. The following note gives the desired explanation.

While each of other joint-stock companies confines itself to a particular activity, banking companies, being credit institutions, perform the national service of providing a part of the finance required by agriculture, trade, commerce and industries, which are carried on by individuals, partnership firms and/or joint-stock companies. Without such finance, all these sectors of the nation's economy would be unable to pursue their respective activities to the same extent. Thus, whereas the stock-in-trade of other joint-stock companies consists of particular kinds of goods, the stock-in-trade of banking companies is money, which is needed by all joint-stock companies for pursuing their respective activities. This is seen from the fact mentioned in an article entitled "Bank Advances: June 1953" prepared by the Research Department of the Reserve Bank of India and published in the October 1953 issue of the Reserve Bank Bulletin, that, on 30th June 1953, the total advances of scheduled banks amounted to Rs. 544.87 crores, out of which advances to industrial concerns amounted to Rs. 188.98 crores; the advances made to the cotton industry, jute industry, other textiles, engineering, sugar, vegetable oil industry and chemicals and dyes were Rs. 50.76 crores, Rs. 11.92 crores, Rs. 12.47 crores, Rs. 14.58 crores, Rs. 32.74 crores, Rs. 3.65 crores and Rs. 8.44 crores respectively; the total advances of non-scheduled banks amounted to Rs. 41 crores, out of which advances to industrial concerns amounted to Rs. 6.05 crores. The special position of banking companies and the service which they are rendering to all other joint-stock companies have been recognised by the Planning Commission. According to the Five Year Plan, banking companies are expected to make Rs. 150 crores more in the form of working capital available to industrial companies in the private sector, which has been assigned an important role in the Plan.

Further, the terms of reference of the Committee recently appointed by the Reserve Bank of India, with the approval of the Government of India, under the chairmanship of Mr. A. D. Shroff, bring out the special position of banking companies. The terms are "to examine how increased finance, particularly bank finance, can be made available to the private sector, through sources other than those which are under the consideration of the Taxation Enquiry Commission".

The special position of banking companies is again indicated by the fact that, while other joint-stock companies are subject only to the provisions of the Indian Companies Act, banking companies are subject not only to the provisions of the Indian Companies Act, but also to the much stricter provisions of the Banking Companies Act. Further, additional provisions were incorporated into the latter Act in 1953, so as to impose special responsibilities, which are very onerous, upon the directors of banking companies. Directors of other joint-stock companies are free from such responsibilities. The more important special responsibilities imposed on directors of banking companies, which are in addition, are as follows:—

1. The depositions made by directors in their examination before a High Court can be used in evidence against them in all proceedings, civil or criminal.

2. When a *prima facie* case is made against a Director, the High Court can make an order against him to repay and restore the money or property, unless he proves that he is not liable to make the repayment or restoration either wholly or in part.
3. There is no period of limitation for the recovery of arrears of calls from any director of a bank which is being wound up or for the enforcement by the bank against any of its directors of any claim based on a contract, express or implied; and in respect of all other claims by the bank against its directors, the period is 12 years from the date of accrual of such claims.

Furthermore, banking companies are performing the very important function of collecting money from the people of the country and making it available to the Central and State Governments for economic development in the public sector by investing it in Government securities. This is seen from the fact, mentioned in an article entitled "Investments of Banks: June 1953" prepared by the Research Department of the Reserve Bank and published in the September 1953 issue of the Reserve Bank Bulletin, that, in June 1953, the investments of scheduled and non-scheduled banks in Government securities amounted to Rs. 321.06 crores and Rs. 10.50 crores respectively.

Indian banking companies have a special position as regards their foreign branches also. Indian traders have done business in foreign countries for centuries but, until recently, the finance of foreign trade was in the hands of non-Indian banks. Indian trading firms and companies have had branches all over the world for a long time, but it is only recently that Indian banks have opened branches abroad. This is an innovation greatly to be desired, as it is much to the benefit of Indian banking and trade, but it costs a lot of money for Indian banks to establish and maintain foreign branches. Hence, there is a good case for giving special encouragement to Indian banks to do so, until they become established abroad on something like the scale of foreign banks.

Indian companies and firms are different from banks. They are already established abroad and there is no need for a policy of giving encouragement to them. Their overhead charges need not be anything like those of a bank and they cannot only establish branches without great cost, but also close branches without difficulty, if such branches cease to pay. A bank cannot close a branch abroad, without, at least, loss of prestige and it is not the policy of a bank to close a foreign branch because of a temporary period of bad trade. With a trading firm or company, such considerations would not matter much.

Taxation on bank profits is onerous and where a foreign branch of an Indian bank is established in a country where taxation is higher than in India, the bank has to pay the higher taxation of the country and gets no relief from it in India. If taxation is lower in the country, in which the branch is established, than in India, the bank is required to pay in addition in India the difference between the foreign rate and the Indian rate.

The best method of assisting Indian banks having foreign branches would be to allow each foreign branch to pay the tax levied in the country in which the branch is established, no additional Indian taxation being levied if the rate of the foreign tax is lower than that of the Indian tax. This is not much for Indian banks with foreign branches to ask. It is a benefit which Indian firms and companies trading abroad substantially receive at present, by establishing a separate firm or company in the foreign city. This method is not open to a bank, because a small separate banking company established in the foreign city would not have the resources of, or command the confidence in, the parent bank and would, perforce, have to do less business and make lower profits.

Thus, it becomes clear that if banking companies are enabled to strengthen themselves by the grant of tax reliefs or concessions to them, they will be able to give larger financial assistance to agriculture, trade, commerce and industries of the country.

The Millowners' Association, Bombay.

REPLIES TO THE QUESTIONNAIRE OF

THE TAXATION ENQUIRY COMMISSION.

PART I—THE TAX SYSTEM.

General.

Question 1.—What, in your opinion, should be the objective of a sound tax policy? What should be the place in such a policy of the following objectives:—

- (a) reduction in inequalities of income and wealth;
- (b) encouragement of incentives to work, to save and to invest;
- (c) countering of inflationary and deflationary tendencies; and
- (d) maintenance of the external balance of the economy?

In what directions would you suggest modification of the Indian tax system having regard to these objectives?

The objective of a sound tax policy should be to distribute the burden of taxation as equitably as possible over all sections of the community, bearing in mind the capacity to pay and the state of the economy of the country. India is in a relatively early stage of development in all spheres, i.e., agricultural, industrial, etc., and in its present position and in view of the intention to develop, the tax policy should give primary importance to (b), viz., encouragement of incentives to work, to save and to invest. With this end in view there is scope for reduction in certain direct taxes to provide the necessary encouragement. We concede, however, that in an extreme emergency, tax policy may have the objective indicated in (c) and (d), but that should be limited only to a temporary period, i.e., as long as the emergency lasts. In our opinion, the objective of a sound tax policy should never be the reduction of inequalities in income and wealth by taxation, which would result merely in levelling down of incomes without any material benefit to the community.

Question 2.—What criteria would you suggest for determining the equity of a tax system? How far is it possible to secure it in the Indian tax system?

The equity of a tax system must be linked with the sharing of the burden and the equitable distribution of taxes. At the same time in a democratic state encouragement must be given to individual effort.

Question 3.—Does the Indian tax system conform adequately to the principle of ability to pay or do you think an extension of this principle is desirable and practicable? If so, in what ways?

and

Question 4.—Differing views have been expressed on the extent to which the taxable capacity of various sections of the community has been used by the Indian tax system. What is your view on the subject?

We feel that the present system of taxation might be modified to ensure that all sections of the community bear an equitable share of the tax burden, by levelling taxes wherever possible and by devising indirect taxes like salt tax, levy of a surcharge on land revenue, levy of betterment charges and other similar forms of taxation, which are capable of securing a high revenue yield and at the same time spread the burden over all sections of the population. Such taxes would be relatively easy to collect with the existing machinery.

Question 5.—The proportion of tax revenue to national income in India is considered small relatively to several other countries. Do you think it is proportionate can be raised, and, if so, what tax changes would you suggest for the purpose?

We consider this comparison misleading on account of India's enormous population and low individual resources which put 99 per cent. or more of the population below the level of direct taxation. We do not feel that existing tax-payers can reasonably carry a heavier direct burden, and we think the only scope for raising the national proportion is by the imposition of certain indirect taxation indicated by us elsewhere. Please see also our answer to Question 4.

Question 6.—Do you think that the relative place of direct and indirect taxes in the Indian tax system is satisfactory?

We consider that the relative place of direct and indirect taxes in the Indian tax system is not satisfactory.

Question 7.—Do you consider that non-tax revenues are likely, in future, to occupy a more important place than hitherto in the public revenues of India? If so, please state the sources of non-tax revenue you

have in view and indicate to what extent they may be expected to contribute to the public exchequer.

If by the expression "non-tax revenues" the Commission mean income from such institutions as Posts & Telegraphs, Mint, Railways and establishments run by the State, then the answer is that it all depends on the extent to which Government intend to proceed with nationalisation of trade and industry.

Question 8.—Do you agree with the view that receipts from particular taxes should not, as a rule, be funded or earmarked for specific purposes?

We do not agree in principle with particular tax being levied, collected or funded for specific purpose.

Question 9.—Do you think that it is desirable, under certain conditions, to levy cesses for specific purposes?

The answer generally is in the negative, but where a cess is levied, the proceeds should be earmarked for the direct benefit of the industry or trade which pays the levy.

Question 10.—State undertakings, commercial, industrial, etc., are coming to play an increasing important part in the economy of the country. Have you, from the point of view of their significance as a source of revenue, actual or potential, any comments or suggestions to make on matters such as the further extension of State undertakings or their policies in regard to pricing, in so far as they may be relevant to tax policy?

We are opposed to any extension of nationalisation of trade and industry.

In the case of trade and industry already taken over and run by the State, such industries should be required according to commercial usage and practice, to pay expenses and out-goings, provide for depreciation, pay income-tax and super tax according to the commercial scale, make allocations for replacements and rehabilitation, hand over to Government an amount equivalent to a reasonable dividend on capital invested, and fund the balance against a future emergency. In the matter of prices, we are against State-managed trade and industry competing against private-owned industry either in the home or export markets, but in the case of Government managed utility industries, we suggest they should run on a non-profit basis after providing for depreciation and interest.

Question 11.—Would you suggest that the net surplus earned by State owned undertakings should accrue to general revenues or be carried to a fund for financing projects of development or be re-invested in the undertakings concerned?

We have already answered this question in the preceding paragraph.

Incidence of taxation.

Question 12.—In examining the incidence of taxation various classes of people, which of the following factors, singly or in combination, would you suggest as the basis of differentiation—

- (a) income,
- (b) occupation,
- (c) rural or urban residence?

Is there any other basis which may be considered?

We are of the opinion that the basis of differentiation for the purpose of taxation should be income.

Question 13.—Do you think that the burden of the present tax system—Central, State and Local—is fairly distributed among—

- (a) various classes of people?
- (b) different States?

(a) No.

(b) No.

Question 14.—Have shifts in the distribution of income in the community in recent years, altered the relative incidence of taxation on various classes of people? If so, to what extent?

We think there have been shifts in the distribution of income in the community in recent years. For example, we think that agricultural income, particularly of cultivators of economic holdings and earnings of industrial workers, have gone up appreciably even in terms of real income. We do not think, however, that this has altered the relative incidence of taxation on various classes of people as the classes whose income has increased did not and generally still do not pay taxes.

Question 15.—Do you think that the cost of compliance with tax regulations adds materially to the burden of taxation? If so, in respect of what taxes? Please give details.

The question is not very clear to us, but we presume that the Commission desire to find out whether and if so to what extent, taxation imposes any further consequential burdens on us. If so, our answer is in the affirmative. This is wholly and solely due to the over-laboration which prevails in the collection of all taxes direct or indirect and the staff which has to be retained for maintaining the various registers, returns, etc., etc. For instance, the cumulative effect of all taxes, whether they be Central, State or municipal, on a company engaged in the manufacture of cotton spinning and weaving, is very considerable. In addition to the statutory registers and returns which have to be maintained and submitted to the various authorities, information on a variety of points has to be supplied every time an assessment is made or a duty is paid. It is not a question of a mill company answering the information required in connection with its own assessment, but it has to supply information regarding the assessment of other mills also. We have income-tax, sales tax, octroi, customs, excise duties, and particularly the last mentioned, which entail clerical work quite out of proportion to the taxes which have to be paid. Further, the complicated nature of the statutes and absence of clear cut rulings or instructions entail considerable delay, waste of time and money in appeals and counter appeals.

Question 16.—Do the benefits accruing from public expenditure have a bearing on a consideration of the burden of taxation? If so, how would you take this into account in considering the burden of Indian taxation?

The benefits accruing from public expenditure should have a bearing on the burden of taxation to be imposed. Recently, increased expenditure is being incurred in conferring benefits particularly on certain sections of the population, and it is thought that the classes which stand to benefit by these measures should make a correspondingly higher contribution to the national revenues.

Question 17.—Do you think that the tax burden weighs particularly heavily on any individual industry or occupation? If so, please furnish the Commission with the evidence on which you rely.

Reference is invited to the enclosed booklet published by the Association towards the end of 1952.

Taxation and Economic Development.

Question 18.—What role would you assign to taxation vis-a-vis various types of borrowing in finding the additional resources required for the development programme of the country?

We would prefer Government borrowing as far as they can out of institutional savings and savings by individuals, and if the amount thus raised is not sufficient, the balance may be secured by means of indirect taxation such as salt duty, etc. In this connection, the point must be made that the ability to save is linked with the rate of tax which has to be paid by the sources from which Government can borrow, in the sense that high rates of direct taxes will make saving and investment impossible.

Question 19.—In maximising the resources required for the financing of development, what degree of importance would you assign to:—

- (a) economy and rationalisation in expenditure,
- (b) prevention of tax avoidance and tax evasion,
- (c) higher rates of existing taxes,
- (d) fresh taxes,
- (e) development of non-tax revenues?

We would allot the first place to economy and rationalisation in state expenditure, and the second place to (b) prevention of tax avoidance and tax evasion. We do not think that there is any scope for higher rates of existing taxes or fresh taxes, certainly in the case of direct taxes. We are opposed to the development of non-tax revenues, if the reference is as we understand to the income which the State may derive by a further extension of nationalisation of trade and industry.

Question 20.—Under the Five-Year Plan, the public sector is expected to undertake a larger investment; an important place is also assigned to the private sector in the development programme. How would you devise a tax policy suitable to the development programme of the country in both sectors?

Question 21.—What part can tax policy play in stimulating capital formation in the private sector consistently with the needs of the public sector?

Investment whether it be in the public sector or the private sector, requires as a condition precedent to its success, the ability to save by the population in the

case of public borrowing, and inducement to industry in the private sector to save and plough back in industry itself a reasonable share of the profits for future development, expansion, rehabilitation, etc.

Question 22.—(i) Is there evidence for the view that the rate of private capital formation in the community has been lower in the last few years as compared to the pre-war period? What factors, in your opinion, account for the decline?

(ii) Has there been a shift in recent years in the sources of capital formation in the private sector as between individuals, corporations and other institutions?

(i) We do not consider that pre-war affords a satisfactory basis for comparison for the purpose which this question has in view, in view of the fact that the rupee before the war was worth about four times its present value.

In our view, the proper basis of comparison would be after the separation of India, say, 1947, and in our opinion, the ability to save today is less than in 1947 and very much less than what it was in 1938-39.

(ii) Yes; there has been a shift from individuals to corporations and institutions.

Question 23.—Do you think that tax relief in respect of persons in the middle-income group would assist the growth of savings or mainly promote consumption?

We think it would assist in the growth of savings.

Question 24.—The Planning Commission have given an estimate of the rate of progress in regard to national income and consumption standards on the assumption of 50 per cent. of the additional output going into investment each year after 1956-57. What measures in the field of taxation are necessary if this assumption is to be realised?

We do not agree with the estimate of the Planning Commission. In our opinion, the estimates given by them are very high.

Question 25.—Do you accept the view that some regulation of consumption standards is desirable as a means of releasing larger resources for development? If so, what part, in your view, can tax policy play in this process and what should be the relative role of direct and indirect taxes in achieving the purpose?

Consumption standards are already very low in this country, and any regulation would result in a still lower standard and would, therefore, be undesirable.

Question 26.—How far can tax policy help to promote the efficiency of the productive system? Do you think that multiplicity of taxes in India in respect of the same commodities and their lack of uniformity from State to State affect the allocation of resources in the community and hence the efficiency of the economy? Have you any suggestions for the rationalisation of the country's tax structure in these respects?

We consider simplification of the tax system would add to the efficiency of the productive system. Also we think that the capital equipment required by industry and all the stores and raw materials required in the course of manufacture should be allowed free of import duty, octroi duty, sales tax and other impositions by the centre, state, municipal authorities and so on.

With regard to the second part of the question, we believe that taxes like sales tax do affect the resources of the community, in the sense that the same tax has to be paid on the same goods in different parts of India, from the point at which the goods leave the factory in one state and go into consumption in another state, resulting in the ultimate consumer being mulcted in the sum total of the taxes paid at all stages. We suggest that in order to get over all these difficulties, such taxes should be centralised, and on collection, the Union Government should distribute the proceeds in such proportion as they may decide.

Question 27.—How far in your view could the tax system be used to secure any order of priorities in the development programme in the private sector?

We are opposed to the tax system being used to secure priorities in the development programme in the private sector.

Question 28.—What are the possibilities and limitations of tax policy as an instrument for economic development:—

- (a) by influencing over-all demand,
- (b) by reducing consumption and unessential investment,
- (c) by positive inducements for desirable investments,
- (d) by redistribution of incomes,
- (e) in other ways?

Please see our answers to Question 27.

Question 29.—How would you assess the scope and efficiency of tax policy as compared to monetary policy and direct controls as an instrument of planned economic development in India?

In the present and probable future economic climate, we consider the economic development of India more likely to respond to incentives in the form of tax concessions, where possible, and that if enabling measures have to be introduced, beneficial results are more likely to be achieved by monetary policy than by the imposition of controls or other specific compulsions.

Question 30.—Do you think that the present tax system in India makes for a reduction in inequalities of income and wealth?

Yes.

Question 31.—What modifications in the tax system would you suggest for securing a larger degree of economic equality, consistently with maintaining the incentives to capital formation and higher production?

There is no scope for modification in the present tax system consistently with maintaining the incentive to capital formation.

Question 32.—What place would you assign to public expenditure as compared with the tax system in achieving a greater measure of equality of income?

This question, we understand means the equalization of incomes either by raising the level of income by public expenditure or lowering the level of income by higher taxes. If this is so, the answer is that taxation in the case of incomes, particularly higher incomes, has already gone too far, and there is, so far as we are aware, no scope for its increase as a means of reducing inequality of income.

If Government really desire to secure a certain measure of comparability between various income groups, then that should be aimed at by increasing public expenditure on behalf of those sections whose incomes in Government's opinion are low, and public expenditure should, as far as possible, be on productive work. The resources and capacity of the country must not be forgotten in this context.

Question 33.—Have you any changes to recommend in tax policy in relation to the investment of foreign capital in India?

We feel that so far as tax policy is concerned, there should be no discrimination between foreign and indigenous capital.

Question 34.—Article 269 of the Constitution enumerates the following taxes which may be levied and collected by the Union but the proceeds of which are to be assigned to the States:

- duties in respect of succession to property other than agricultural land;
- estate duty in respect of property other than agricultural land;
- terminal taxes on goods or passengers carried by railway, sea or air;
- taxes on railway fares and freights;
- taxes other than stamp duties on transactions in stock exchanges and futures markets;
- taxes on the sale or purchase of newspapers and on advertisements published therein.

How do you assess the possibilities of adding to the country's tax resources in respect of the above items?

and

Question 39.—To what extent and as regards what taxes should the powers of the Centre to impose surcharges under Article 271 of the Constitution be used?

We have no comments to make, except to point out that taxes are already very heavy.

Question 35.—Other possible ways of adding to tax receipts which have been suggested are taxes on capital, reintroduction of the salt duty, surcharges on land revenue, betterment levies, agricultural income-tax, social security taxes and modification of the policy of prohibition having regard to the directive principles of the Constitution. What are your views regarding the desirability and the probable scope of each of these forms of taxation?

Our views are as under:—

Taxes on capital.—We are opposed.

Salt duty.—We are in favour of re-imposition of salt duty.

Surcharge on land revenue, Betterment levy, Agricultural income-tax.—There is scope for increase in

land revenue, the imposition of a betterment levy and also agricultural income-tax.

Social security taxes.—If the intention is that these taxes should come out of employers, then we draw attention to the heavy impositions already in existence; if the tax is to come from employees, then we have no objection.

Modification of policy of prohibition.—We are in favour from the revenue point of view.

Question 36.—Do you consider it desirable and feasible to levy a tax on unearned increments in value of land and other property as a result of public projects of development?

We do not consider it desirable or feasible.

Question 37.—What measures would you suggest for increasing the receipts from existing sources of revenue?

By simplification of existing systems of collection and adoption of more efficient methods of tax collection.

Question 38.—What other new sources of taxation can you recommend?

Please see our answers to Question 35.

Question 39.—Already answered along with question 34.

Taxation and inflationary and Deflationary Situations.

Question 40.—What are the scope and limitations of tax policy as an instrument for dealing with inflationary or deflationary situations in Indian conditions?

Question 41.—In countering inflationary or deflationary conditions in the economy, what part would you assign to changes in the following:—

- direct taxes,
- indirect taxes—
 - import duties,
 - export duties,
 - excise duties,
 - sales tax?

Question 42.—To what extent is it possible to increase the inherent capacity of the tax system to counteract inflationary or deflationary conditions in the economy?

Question 43.—What are your views in regard to the relative importance of public expenditure policies in moderating the forces of inflation and deflation in Indian conditions?

Question 44.—Apart from using tax policy to counter inflation or deflation in the economy as a whole, would you suggest tax changes for dealing with the effects of rising or falling prices on particular groups of tax-payers or sectors of the economy?

Question 45.—How do you assess the present situation in regard to the strength of inflationary or deflationary influences, and what adjustments, if any, in taxation are indicated in the light of your views?

We agree to the application of these forces, due regard being had to the conditions prevalent at any given moment, but we cannot say what the effect of such application will be in particular circumstances; in any event, their effect on the Industry should receive special attention before they are applied.

PART II—DIRECT TAXES.

INCOME-TAX.

Residence.

Question 46.—Do the provisions of the Income-tax Act (Sections 4A and 4B) regarding the determination of residence of various assesses, viz., individual, Hindu undivided family, firm, association of persons and company, require any modification? In particular, what is your view regarding the retention of the category described as "not ordinarily resident"?

There might be three classifications as residents, non-residents, and temporary residents, the last-named replacing "not ordinarily resident".

It is further suggested that in Section 4A(c), the sole test of a company's residence in the taxable territories in any year should be with reference to the situation of the control and management of its affairs. In other words, the other test, namely, the income arising in taxable territories exceeding the income arising without should be omitted.

Income.

Question 47.—Does the definition of "income" (Section 2(6C)) require any modification.

Where as a result of the sale of any building, machinery or plant, the amount realised exceeds the written down value thereof, then such part of the realised value as exceeds the written down value and up to the original cost, is at present being treated as the profit of the year in which the sale has taken place and assessed to tax at the rate applicable to that year. It is suggested that such excess be spread over a period of at least three years for purposes of assessment. If the sale of machinery results in a loss, such loss should be allowed as an expense in the year in which the machinery was sold.

Where as a result of fire or other catastrophe, compensation moneys are received from insurance companies in respect of any building, machinery or plant, which has been discarded or demolished or destroyed as a result of such fire or other catastrophe and the amount so realised is less than the written down value thereof, the position at present is that the difference is treated as a loss in the year concerned for purposes of taxation.

Where, however, the moneys so received exceed the written down value, the position at present is that the difference between the original cost and the income-tax written down value is treated as profit in the year of receipt and is subject to taxation. This may mean an actual cash shortage so far as actual machinery or building replacements are concerned. It is suggested that such receipts on account of insurance should not be subject to tax, and that as a *quid pro quo*, the value of the assets for income-tax purposes, for calculation of depreciation, should be the cost of the assets as reduced less the income-tax depreciation already allowed in the machinery destroyed.

Question 48.—Are there any receipts or gains which are not taxed at present but which, in your opinion, should be taxed and vice versa? In particular, what is your view regarding the taxing of capital gains?

First part.—No.

Second Part.—We are opposed to capital gains tax.

Question 49.—Have you any comments on the present position regarding taxation of profits, which accrue or arise abroad, on their repatriation to India?

In the general interests of the country, repatriation profits accruing or arising abroad should be encouraged, both in respect of companies and individuals, and this should be borne in mind in devising taxation.

Question 50.—What change, if any, is called for in the definition of "dividend" (Section 2(6A)); e.g., in relation to "bonus shares"?

We are opposed to any change in the definition of dividend, which would result in the bonus shares being defined as dividends.

Question 51.—Do the provisions of the Income-tax Act relating to the taxability of non-residents through their business connections in India in respect of income deemed to accrue or arise within the taxable territories (Sections 42 and 43 of the Income-tax Act) affect adversely the interests of persons engaged in foreign trade? If so, what modification would you suggest in these sections?

Yes, there should be clear distinction between what constitutes trading in India and what constitutes trading in India; in particular, where the agent is not concerned with payment, he should not be held liable for tax of his principal. We suggest that existing sections 42 and 43 of the Income-tax Act should be deleted and relevant sections of the U.K. Act be incorporated in the Indian Act.

Question 52.—What modification would you suggest in the definition of "agricultural income" (Section 2(1)) to avoid the contingency of the same income being taxed by the Central Government as well as the State Governments, e.g., in respect of income from forests, dividends from agricultural companies, etc.?

Question 53.—Are you in favour of integrating agricultural income with non-agricultural income for rate purposes? If so, which of the following methods would you advocate:—

- (i) Aggregation of agricultural and non-agricultural incomes only under the State Acts;
- (ii) Aggregation of agricultural and non-agricultural incomes only under the Central Act;
- (iii) Aggregation of agricultural and non-agricultural incomes both under the State and the Central Acts?

Please discuss the administrative, constitutional and other problems that are likely to arise if any of the above alternatives is adopted.

Question 54.—Would you recommend the abolition, by suitable amendment of the Constitution, of the distinction between agricultural and non-agricultural incomes and the taxation of both types of income, aggregately under a Central Act?

We have no suggestions to put forward, but we consider that the agricultural population should pay an adequate share of taxes in one form or another.

Question 55.—Is the treatment given to irregular and fluctuating income in the present law satisfactory? In particular, should any changes be introduced—

- (i) to average income over a number of years where receipts are irregular and fluctuating;
- (ii) to spread lump sum receipts over a number of years?

The treatment given to irregular and fluctuating income in the present law is not satisfactory.

(i) Yes.

(ii) Yes.

Exemptions

Question 56.—Do you think the present provisions regarding exemption of charitable and religious trusts need any modification? If so, in what respects?

No comments.

Question 57.—(i) Should the business profits of co-operative enterprises, which are now exempt, be charged to income-tax and super-tax? If so, should co-operative societies be treated as companies or should a lighter levy be imposed? In case the exemption is continued, should it be restricted to certain categories of co-operative enterprises?

(ii) Do you agree with the view that the income derived by co-operative housing societies by way of rent should not be treated as income from property assessable to income-tax? Would you, in this respect, differentiate between tenant co-partnership housing societies and other types of housing societies?

(iii) It has been suggested that there are divergent decisions by different income-tax authorities in respect of assessment of income of co-operative societies from sources other than business. If this is so, please indicate such decisions and the measures you would suggest to secure uniformity in assessment.

(i) We suggest that the present privileged position of co-operative societies should be accorded only to those societies which cater only for their members. All other cases should be treated on the same footing as joint stock companies for purposes of taxation.

(ii) & (iii) No comments.

Question 58.—Are you in favour of continuing the concessions given to new industrial undertakings under section 15C of the Income-tax Act? Have initial and extra depreciation allowances made the concessions practically infructuous? If so, what are the directions in which the provisions of this section should be modified?

We are in favour of continuing the concession given to new industrial undertakings under Section 15C of the Income-tax Act, but we suggest that this extension should be both in respect of the percentage of permissible allowances and the period of time. In regard to the latter, we suggest that the time limit should be five years from the time the new industries begin to make taxable profits.

Question 59.—A suggestion has been made that banking profits of foreign branches of Indian banks should be given concessional treatment for tax purposes in order to encourage the opening of branches abroad. What are your views?

We agree with this suggestion. Such concession should, however, be reviewed from time to time, as there is the possibility of similar concessions being asked for by other assesses in India. We would suggest that such concessional treatment should extend for a period of three years so as to enable Indian banks to develop their branches abroad.

Question 60.—Should any liberalisation be made in the present limits of exemption from tax of life insurance premia and contributions to provident funds?

No comments.

Allowances.

Question No. 61.—(i) Do you favour the grant of larger depreciation allowances to assist industry to finance the considerably increased costs of replacement of assets? If so, how and in what form should they be given—

- (a) by larger depreciation allowances on new assets;
- (b) by revalorisation of existing assets;
- (c) by treating the excess of replacement cost over original cost as revenue expenditure;
- (d) by any other method?

(ii) What is the justification for assistance from public resources to certain classes of tax-payers only by way of covering partially the excess of replacement cost over original cost of old assets?

(iii) In case adequate justification exists for assistance by Government in the form of tax concessions to meet the situation, what safeguards should be prescribed to see that the funds so made available are utilised for the purposes for which they are intended?

(i) Yes; we are in favour of (b), i.e., revalorisation of existing assets. In the case of new assets, the present rates of depreciation allowances are adequate and should be continued.

(ii) If by "public resources", tax concessions are visualised, then we think there is justification for such concessions, but if actual disbursements of public funds is contemplated, then we can only visualise justification in exceptional cases, e.g., public utility concerns.

(iii) Any concessions so allowed should be permitted to be spent on the specific purpose of rehabilitation, subject to such control which Government might choose to exercise.

Question No. 62.—Are any changes called for in the classification of assets for purposes of depreciation, rates of depreciation and methods of computing the allowances?

We have no changes to suggest so far as classifications are concerned.

As regards rates, we suggest that factory buildings be rated at 7-1/2 per cent. and non-factory buildings at 5 per cent.

As regards method of computing depreciation, we suggest reversion to the original straightline method.

Question No. 63.—Should any tax concessions be given to encourage development of mineral resources? If so, what form should they take? In particular, should depletion allowance on wasting assets be allowed? How should it be computed for different kinds of assets you have in view?

Question No. 64.—In what form would you provide for personal and family allowances—

- (i) exempting the first slice of income from tax; or
- (ii) providing specific allowances for family and dependents?

(i) Income-tax :

On the first Rs. 1,500 of total income	Nil
On the next Rs. 3,500 of total income	9 ps. in the rupee.
On the next Rs. 5,000 of total income	1 as. 3 ps. in the rupee.
On the next Rs. 5,000 of total income	1 as. 9 ps. in the rupee.
On the next Rs. 5,000 of total income	2 as. 3 ps. in the rupee.
On the next Rs. 5,000 of total income	3 as. in the rupee.
On the balance of total income	4 as. in the rupee.

(ii) Super-tax :

On the first Rs. 25,000 of total income	Nil
On the next Rs. 15,000 of total income	2 as. in the rupee.
On the next Rs. 15,000 of total income	3 as. in the rupee.
On the next Rs. 15,000 of total income	4 as. in the rupee.
On the next Rs. 15,000 of total income	5 as. in the rupee.
On the next Rs. 15,000 of total income	6 as. in the rupee.
On the next Rs. 15,000 of total income	7 as. in the rupee.
On the next Rs. 15,000 of total income	7-1/2 as. in the rupee.
On the balance of total income	8 as. in the rupee.

The rates of income-tax and super-tax we have given are only illustrative. In our opinion, the total incidence of tax is too high, and even these rates are such that private investment in the country will soon dry up altogether.

To encourage investment in new industry, we suggest that a portion of such investment should be free of tax.

(e) No.

Question No. 67.—Have you any change to suggest in the exemption limit for individuals (Rs. 4,200) and for Hindu undivided families (Rs. 8,400)?

No comments.

In the case of (i) do you consider that the first slice—Rs. 1-1,500—should be revised? In the case of (ii) what treatment would you give to the Hindu undivided family?

No comments.

Question No. 65.—Should the present law regarding admissible expenses (section 10(2)) be altered? If so, please indicate, with reasons, the items of expenses (i) which are not now admissible but, in your view, should be admissible and (ii) which are now admissible but, in your view, should not be admissible?

The following expenses should be allowed under Section 10(2):—

- (a) cost incurred by an assessee in a successful tax appeal;
- (b) expenditure incurred by an assessee in safeguarding the reputation of his business whether it be in civil or criminal proceedings;
- (c) furniture and other assets should be brought within the scope of Section 10(2)(vii);
- (d) Section 10(2)(xv) was recently amended, laying down that what cannot be classified under any of the clauses (i) to (xiv), cannot be claimed under clause (xv). This is very unfair to the assessee, for the reason that a expenditure which, though incurred wholly and exclusively for the purpose of the business profession or vocation, stands disallowed simply because it does not conform to the allowance envisaged in clauses (i) to (xiv). It is, therefore, suggested that the original clause should be restored.
- (e) The word "current" occurring in Section 10(2)(v) should be deleted.

Question No. 66.—(a) Are you in favour of combining income-tax and super-tax into a consolidated levy?

(b) What are the merits or demerits of such step from the point of view of (i) assessee (ii) administration?

(c) Are you satisfied with the degree of progression in the present rate structure (both income-tax and super-tax) especially in regard to its economic effects?

(d) In case you consider a change is necessary what alternative rate structure would you recommend?

(e) Should the rate of surcharge levied under Article 271 of the Constitution also be graduated?

(a) No.
(b) In the case of the assessee, it may mean the perpetuation of the present high rates of taxes as might make taxes less flexible.

(c) No. We consider that the degree of progression in the present rates structure is excessively steep.

(d) Taking the present rates as a guide, our suggestion is as follows:—

Differentiation.

Question No. 68.—(a) Are you in favour of a distinction being made between earned and unearned income? What is the economic justification for such a distinction?

(b) Is the present definition of "earned income" in section 2(6AA) of the Income-tax Act adequate in this respect or would you suggest any modification?

(c) Should the quantum of relief now afforded be extended or reduced? If so, to what extent?

(a) The present distinction between earned and unearned income should be continued, because an all-

ance in the case of earned income is in the nature of a depreciation allowance to the person earning the income through his own efforts.

(b) No. We suggest that the definition of the expression "earned income" in Section 2(6AA) be enlarged so as to include income derived from investment of provident fund moneys, gratuity funds payable on retirement, on the analogy of the pension being included in salaries for purposes of computing earned income relief.

(c) We consider that the quantum of relief now afforded should be extended. The ceiling of Rs. 4,000 on earned income allowance should be increased to one-fifth of the total income or Rs. 6,000 whichever is less. There should also be other allowances such as personal allowance, allowance for wife (one only) children and dependants.

Miscellaneous.

Question No. 69.—Have you any changes to suggest regarding the principles followed in valuing stocks of a business for assessment purposes?

So long as the company follows the method of stock valuation consistently and regularly, it should be accepted for tax purposes, whether it is cost or market value, or cost or market value whichever is lower. If the method followed by the company is cost or market value whichever is lower, then the assessee should be entitled to value each item of the stock on the basis of cost or market value whichever is lower, instead of valuing all the stock at cost and then at market value and taking cost or market value whichever is lower in the aggregate as the basis of stock valuation. Any stock which has depreciated or has become obsolete, should be allowed to be written down to its market value in any of the methods of stock valuation followed by the assessee.

Question No. 70.—Do you consider that any change is called for in the method of assessment of the Hindu undivided family? If so, in what respects?

No comments.

Question No. 71.—Should exemption from income-tax be allowed in respect of voluntary surrender by managing agents of the whole or a part of managing agency commission? What safeguards should be laid down against misuse of such a provision?

Yes; but if it is given up, the managing agents should not be entitled to claim it again at a later date.

Question No. 72.—On what basis would you suggest that double income-tax avoidance agreements should be concluded between India and other countries?

The double income-tax avoidance relief should be based on the lines of the agreement entered into between India and Pakistan, namely, that each country should subject to tax, income which accrues or arises in that country, making no attempt to tax income arising abroad. This will avoid the assessee having to claim relief at both ends to the extent of half the country's rate.

Question No. 73.—Is the present law relating to determination of "bona fide annual value" of property and deductions allowed from it satisfactory? If not, please give any alternative proposals you have in this respect.

We do not consider that the present deductions allowed in the assessment of income from property are satisfactory, with the result that an assessee is made to pay taxes on income which is on an artificial basis and which he has never received. The allowance of one-sixth for repairs against the bona fide annual value of property, based on pre-war rate, has no relation to the present cost of repairs which has gone up by 300 to 400 per cent. since 1939. Similarly, outgoings in the nature of municipal taxes should be allowed in full as against the present practice of allowing only one-half of the amount of such taxes. At present, the urban immovable property tax is not allowed on the ground that it is not a tax levied by the local authority but a tax levied by the State Government and collected by the local authority on behalf of the State Government. All taxes on property with the exception of income-tax on the property incomes should be allowed as deductions in the assessment under Section 9. Such deductions are allowed in the assessment of business income under Section 10 of the Act and the effect of not allowing them under Section 9 is to assess income which has never been received by an assessee.

We, therefore, suggest that the assessment of property under Section 9 should be based on actual rent receivable less the expenditure incurred for the purpose of earning that income. The artificial basis of "bona fide annual value" should be deleted, except where the premises are occupied by the owner.

Another suggestion that we have to make in this connection is that where an employer provides cheap housing for his workers, he should be allowed at the

time of assessment of his business not only all the outgoings in respect of such residential accommodation, but also a reasonable amount of depreciation which would enable him to replace the structure at the appropriate time.

Question No. 74.—Is any change required in respect of provisions relating to carry-forward of losses? Are you in favour of allowing losses to be carried backwards in case of cessation of business?

A change is required in respect of provisions relating to carry forward of losses in the case of cessation of business, and we suggest that where a business is discontinued, unabsorbed losses should be allowed to be carried backwards for a period of two years and allowed to be set off against any profits made in those years.

We would further suggest that even in the case of a going concern, the loss should be allowed to be carried backwards for a period of two years immediately preceding the year of assessment, in which case, the carry forward may be restricted to four years for the balance of the losses which are not absorbed by carry back to such two immediately preceding years.

Another amendment that we would like to make is that the word "same" occurring in section 24(2) should be deleted.

Question No. 75.—Do the provisions relating to the payment of advance tax under section 18A of the Income-tax Act need any modification?

It is suggested that dividend income should not be subjected to advance payment of tax under Section 18A except where the dividend is actually received. We suggest, therefore, that dividend income should be subjected to the same treatment as Managing Agency commission under Section 18A(4).

We also suggest that the practice of allowing credit interest on advance payments should be re-introduced. It is wrong, in our opinion, to charge penal interest on deferred payments and not allow interest on advance payments.

Question No. 76.—Do the principles underlying the assessment under section 34 of the Income-tax Act need any modification?

Where the Income-tax Officer re-opens an assessment made under Section 34, on the ground that some income has escaped assessment, then he should be entitled to revise the figure of assessment within a period of four years where an assessee has not deliberately avoided the tax, but it is necessary to provide that where as a result of the enquiry, the Income-tax Officer comes to know that far from there being an under-assessment, there is an obvious over-assessment, then he should be empowered to give relief instead of the present practice of dropping the proceedings against the assessee.

Question No. 77.—What measures would you suggest for simplifying the procedure for assessment in order to reduce the cost of compliance with tax regulations?

We suggest that the transfer of officers during the pendency of an assessment proceedings should be avoided.

The number of questions asked in connection with the assessment proceedings so far as the cotton textile industry is concerned, is increasing every year and has already assumed unreasonable proportions. It is suggested that the number of questions be reduced and confined to matters strictly relevant to the assessment in question. There is also an increasing tendency on the part of the Income-tax Department to summon mills to compile information which they propose to use with reference to the assessment proceedings of other mills. This, in our opinion, should be discouraged in view of the fact that compliance with the Income-tax Officer's summons entails enormous amount of work on the mills concerned.

Question No. 78.—It has been suggested that the Appellate Tribunal should have powers to enhance assessments in the same manner as Appellate Assistant Commissioners have. What is your opinion?

No; we would also suggest that the powers at present conferred on the Appellate Assistant Commissioners should be withdrawn since these powers are already vested in the Commissioner of Income-tax.

Taxation of Companies and Shareholders.

Question No. 79.—Do you recommend that an element of progression should be introduced in the corporation tax?

Question No. 80.—Would you advocate different types of corporate enterprises, e.g.,

- (i) small industries;
- (ii) cottage industries;
- (iii) private limited companies or what may be termed proprietary companies;

(iv) holding companies?

No.

Question No. 81.—There is a demand for the exemption of inter-corporate dividends from corporation tax. Do you consider this justified and, if so, why?

As far as corporation tax is concerned, dividends in the case of holding companies constitute double taxation; not only the various units forming the inter-corporate ring but also the ultimate shareholders will be liable to super-tax.

Question No. 82.—Do you think that any special provisions are necessary for the assessment of—

(a) banks; and

(b) investment companies?

Do existing rules relating to assessment of insurance companies, especially mutual insurance associations, require any change? If so, in what respect?

No comments.

Question No. 83.—Do you think that differentiation should be made between distributed and undistributed profits of companies for tax purposes? If so, on what grounds? What change would you suggest in the present quantum of differentiation in favour of undistributed profits? Should the concession in future be restricted to particular industries?

If the tax concession in favour of undistributed profits is allowed to continue as at present or in a modified form, what measures would you suggest to ensure:

(a) that retained profits are not used as a device by shareholders of private limited companies to evade super-tax;

(b) that retained profits are actually applied for productive purposes?

In particular, are the provisions of Section 23A of the Income-tax Act satisfactory? If not, what changes would you suggest?

First para.—The answer is yes; on the ground that the industry can plough back the profit into the business and use it for productive purposes, a process which should be encouraged.

As regards the quantum, the present quantum is not sufficient; it should be increased to afford greater investment and might be fixed at two annas in the rupee. The concession should not be restricted to particular industries.

Second para.—The present powers of the Income-tax Officers under Section 23A are sufficiently wide. The definition of the expression "dividend" in section 2(a) of the Act is sufficiently adequate to prevent misuse of the concession.

Third para.—Some discretion might be vested in the hands of the assessment officers in so far as the quantum of dividend under Section 23A is concerned. It should not be compulsory for any private limited company to declare dividend at 60 per cent. provided such amount is invested in productive channels. As regards the safeguard to ensure that the retained profits are utilised in productive channels, it should not be difficult to lay down that only such portion of the profits will be exempted from the operation of this section as will be actually employed in the productive channels to the complete satisfaction of the Income-tax Officer. Any amount invested otherwise may be liable to the operation of this section.

If the Officer is satisfied that the section should be applied, then the assessee should be given an opportunity to declare upto the statutory percentage.

Question No. 84.—Do you think, in view of the fact that profits distributed by a company are subjected to corporation tax, it is appropriate that they should also be charged to super-tax in the hands of shareholders? If not, what are your suggestions in this regard?

Income-tax is levied on the company on its total income. Corporation-tax is levied on the company, not on the income, but on its corporate existence although the same is measured by the total income of the company. If corporation tax is levied on the company, not on the income but on account of its corporate existence, it is reasonable that corporation tax like any other tax should be allowed to be deducted as a charge against the profits of the company. If, however, it is held that corporation tax is in the nature of super-tax, i.e., an additional income-tax, then there is no reason why the shareholders should not be given credit not only for income-tax but also for super-tax.

The present practice of adding back super-tax to the company's income and not allowing credit to the shareholders is very inconsistent.

Question No. 85.—Would you consider that industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies

should be required to contribute, from their earnings in the way of income-tax or in other ways, to general revenues?

Yes, where such undertakings compete with ordinary commercial undertakings.

Evasion and Avoidance of Tax

Question No. 86.—What measures would you suggest for the greater use of the services of Chartered Accountants for assisting in the determination of the taxable income of assessee? What obligations should be placed on a Chartered Accountant when he certifies a statement of accounts of an assessee for purposes of income-tax assessment? In particular, with a view to minimising evasion of tax, would you recommend that the certificate of a Chartered Accountant should invariably accompany the return for business income over a certain limit? If so, would you suggest that a form of certificate should be prescribed indicating the scope of the check that should be exercised by Chartered Accountants who render the certificate mentioned above. Do you agree that fees payable by assessee to Chartered Accountants for such certificates should be restricted to a schedule to be prescribed by Government?

Assessee should be free to decide whether or not to avail themselves of the services of a Chartered Accountant for assisting in the determination of their taxable income. The employment of a Chartered Accountant should be on the basis of agreement between him and his client and the Department should not seek to enlarge the functions for which the client has employed a Chartered Accountant. We do not agree that the certificate of a Chartered Accountant is invariably necessary in the case of a Return of business income over a certain limit, nor do we agree that a form of certificate should be prescribed, indicating the scope of check that should be exercised by a Chartered Accountant. The fees payable to a Chartered Accountant should be a matter of arrangement between him and his client and should not be restricted to a Schedule to be prescribed by the Government. When an assessee selects a Chartered Accountant, he makes his choice of his own free will as to the best person in his opinion to handle his work, and therefore, the fees to be charged, as in the case of an attorney should be left to be settled between the client and the Chartered Accountant.

Question No. 87.—What changes would you suggest in the present law relating to the representation of assessee before Income-tax authorities (section 61) in order to ensure—

(i) effective representation of assessee at reasonable fees;

(ii) a minimum level of proficiency on the part of representatives regarding the subject of income-tax law, rules and regulations?

No change.

Question No. 88.—Will it assist in checking evasion if the names of the persons who are penalised for concealment of income are published? No comments.

Question No. 89.—Do you think that the present practice of excluding, from taxable profits, perquisites given to employees of business undertakings results in considerable loss of revenue? If so, please state the perquisites you have in mind, and how they should be dealt with for the purposes of taxation.

No. We are in favour of continuing the present basis.

The first proviso to Section 7 covers the point, and Section 10(2)(xi) covers the point so far as the persons providing perquisites are concerned.

Question No. 90.—In the case of a company under liquidation, what steps, if any, would you suggest for safeguarding payment of tax dues before any payments are made to shareholders?

No comment.

Question No. 91.—Do you think that, in order to minimise evasion and avoidance of tax, there is a case for conferring larger powers on income-tax authorities? If so, what further powers should be given to them? In particular, should powers to search premises and seize documents and books of accounts be given to Income-tax authorities? If so, what is the lowest grade of officer on whom you would confer these powers?

We consider that the present powers are adequate.

Question No. 92.—What precautions are necessary and possible to prevent the creation of an artificial legal entity—a trust or a private limited company or a partnership, especially family partnership—either for avoiding payment of income-tax or for fractioning of income to escape higher rates? Would you recommend the use of penalty rates of tax to minimise such practices?

The present safeguards are sufficient and further expansion would lead to hardship in genuine cases.

Recovery.

Question No. 93.—*In the case of a registered firm, would you advocate recovery of unrealised tax of any partner from the firm as such or from other partners?*

No.

Question No. 94.—*Are present arrangements relating to recovery of income-tax adequate? Would you advocate the Income-tax Department having a separate machinery for enforcing the recovery of arrears of tax?*

The present powers under Section 46 of the Act are sufficient.

Question No. 95.—*What provisions should be made to ensure timely collection of tax from private limited companies? Do you consider that liability for payment of tax in such cases should be placed upon shareholders of the company in proportion to their shareholdings?*

No additional provisions seem to be necessary. We do not consider that the responsibility should be placed upon shareholders.

Question No. 96.—*If income from any property is included for assessment purposes in the hands of a person other than the ostensible owner, would you agree to the tax so assessed being also made recoverable from such property?*

No comments.

General.

Question No. 97.—*What concrete measures should be taken to improve the relations of the Income-tax Department with assessees especially in regard to—*

(i) *provision of free advice to small assessee on the following points:*

(a) *maintenance of accounts in a form acceptable to the Income-tax Department; and*

(b) *matters such as filing returns of income, claiming refunds, facilities for tax payment, expeditious disposal of assessments, etc.;*

(ii) *provision of information on various matters relating to assessment proceedings, such as disposal of refund applications, adjournment applications, examination of records, etc.;*

(iii) *arrangement of work so as to obviate the necessity of assessee or their representatives having to wait in Income-tax Offices for unduly long periods; and*

(iv) *securing the largest measure of agreement on facts between the assessee and the department at Income-tax Officer level?*

The relation between the Income-tax Department and the taxpayers is likely to be improved considerably if the following steps are taken:

(1) A liaison officer is appointed to give free advice to small assessee as regards maintenance of accounts in the form acceptable to the Income-tax Department and matters such as filing returns of income, claiming refunds, facilities for tax payment, expeditious disposal of assessments, etc.

(2) There must be an officer attached to the Enquiry Department specially empowered to give information on various matters relating to assessment proceedings, such as disposal of refund applications, adjournment applications, examination of records, etc., to a large number of taxpaying public, who are ignorant of these proceedings and who cannot afford to employ the services of an expert.

(3) The work in the office should be so arranged in prior consultation with the experts handling a number of cases before the same Income-tax Officer or with the taxpayers' accountants who undertake to appear on behalf of the assessee.

(4) If the Income-tax Officer is not able to take up the assessee's matter on the date appointed and at the time fixed, he should not ask the taxpayer or his representative to wait, but should give immediately a fresh appointment. The convenience of the taxpayer as regards production of books, payment of tax, giving information, etc., should be closely and sympathetically studied.

(5) The Department is likely to secure the largest measure of agreement on facts, if it develops an attitude of trust and sympathy instead of distrust and assumption. The Income-tax Officer should not suspect the assessee, unless he has some definite evidence—direct or circumstantial—for forming an adverse opinion.

(6) The cases of the assessee should be promptly disposed of and the Income-tax Officers should not meticulously scrutinise the accounts every year where the records of the assessee are otherwise clean.

(7) Information should be called for only on the points relevant to the assessee and not information which would enable the Income-tax Officers to trace and check other people's assessments.

(8) Penalty should not be imposed for technical offences and defaults. It should be levied only with a view to punishing recalcitrant and troublesome assessee. The laws should be simple and sympathetically administered and not as now administered with the primary purpose to get as large a revenue as possible, either through over-assessment, extravagant estimation or heavy penalties for technical offences or mis-statements.

(9) Close departmental supervision over the work of assessment officers in respect of issue of assessment notices, calling for supplementary returns and information, hearing of the assessee's cases, final assessment, together with refund proceedings, if any, is calculated not only to facilitate and accelerate matters, but will also avoid development of practices which are none too healthy both from the point of view of Government and the assessee.

Question No. 98.—*What changes would you suggest in the existing arrangements relating to:*

(i) *issue of notices;*

(ii) *simplification and filing of returns;*

(iii) *levy of penalties;*

(iv) *recovery of tax; and*

(v) *appellate procedure and machinery, particularly with reference to administrative control over Appellate Assistant Commissioners?*

(i) The practice of issuing notices on the assessee on the register should continue as hitherto.

(ii) The form of return should not be very elaborate and complicated but simple and intelligible. One suggestion is that an assessee carrying on business should be allowed to return his aggregate income from business under Section 10 and not under separate heads of income as provided under Section 6. All the assets including investments are held by him in course of business and arising as a consequence of his carrying on the business. And, therefore, it would be reasonable to treat it as income arising from one source.

(iii) Penalty should not be levied for technical offences. It must be levied only as a deterrent and a punishment for deliberate infringement of law, e.g., concealment, deliberate omissions or making false statements. It should not be imposed with an eye on revenue.

(iv) It is very difficult to make any definite suggestion except perhaps to point out that the authorities should take into consideration the special circumstances obtaining in the case of each assessee, and in genuine cases penal interest should not be levied on instalment payments. It occurs to us that if recovery of taxes were entrusted to a special department, it might reduce the work of the present assessment department and also speed up assessment work.

(v) We have two suggestions to make under this, namely, the appellate machinery should be absolutely independent of the department, and secondly, the powers of enhancement of the taxes should be taken away from the Appellate Assistant Commissioner as the same are at present vested in the Income-tax Commissioner.

Question No. 99.—(a) *Do you think that undue delay occurs at present in the course of assessment proceedings? If so, what do you attribute this to and what are your suggestions for remedying this?*

(b) *In order that delays of the kind mentioned above do not appreciably affect collection of a substantial portion of the tax due, should any special concessions be provided to assessee to induce them to make advance payment of tax?*

(a) We do think that undue delay occurs for the reason that returns and the information asked for have become over-elaborate leading to wasteful repetition. We, therefore, advocate simplification of the returns and avoid transfer of assessing officers during the pendency of assessment proceedings.

(b) Our experience is that advance payment of tax tends to result in the Income-tax Officer delaying final assessment.

Special Business Taxes

Question No. 100.—*What, in your opinion, should be the circumstances which would justify the levy of Excess Profits Tax or special business taxes?*

E.P.T. should only be considered in a highly inflationary situation, usually associated with war.

Death Duties.

Question No. 101.—*What are your main reactions to the Estate Duty Bill at present before Parliament?*

Question No. 102.—Would you in the matter of rates of levy differentiate between self-acquired property forming the estimate of a deceased and property inherited by him?

No comments.

PART III.—COMMODITY TAXES (CENTRAL & STATE) CUSTOMS

Import Duties.

Question No. 103.—Do you think that any changes are necessary in the Indian Customs Tariff in respect of—

- (i) grouping of commodities;
- (ii) additions to and alterations in tariff items;
- (iii) correlation with the Import Trade Control Schedule;
- (iv) clarification in nomenclature and in units of measurement or weight?

We consider that the Indian Customs Tariff should, in the interests of all concerned, satisfy the following propositions:—

- (a) be closely correlated with the I.T.C. Schedule, and is exact co-ordination of commodities is not possible, at least the general grouping in each should follow the same lines;
- (b) be kept up-to-date to meet the changing pattern of the country's importing needs;
- (c) be such that an importer can ascertain clearly and in advance the category into which his prospective imports fall both as regards admission into the country and rate of duty.

Question 104.—(i) What considerations should govern the fixation of rates of import duties for different groups or sub-groups of commodities or for special tariff items?

(ii) Have you any modification to propose in the present rates of duties in the light of the considerations suggested by you?

(iii) Do you consider that import duties should be reduced in respect of any specific commodities in order to reduce the scope for smuggling?

(iv) Are there any cases within your knowledge where duties on the constituent parts are higher than on the finished product? Is there adequate justification, in your opinion, for this differentiation?

(v) Do you think that owing to high rates of duties the yield on any commodity has reached the point of diminishing returns?

(i) The prime considerations which arise in fixing the quantum of import duties are (a) whether they are for revenue purposes; and (b) whether they are intended to protect an Indian industry against foreign competition. If the duty is levied for revenue purposes, then the quantum should be regulated with reference to the importance of the commodity charged in relation to the national economy, but if the duty is levied for protective purposes, then it should in no event exceed the duty recommended for the purpose by the Tariff Commission. We deprecate the practice of Government invoking the special import control powers for the purpose of granting additional protection to an Indian industry over and above the level of import duties recommended by the Tariff Commission, by banning or otherwise restricting the imports of certain manufactures.

(ii) The wholesale banning of the imports of certain manufactured goods as a sort of protection to the Indian industry over and above the quantum of duties recommended by the Tariff Commission is a disadvantage in the sense that it will leave no incentive to the Indian industry to improve its standard with due regard to the technical developments which take place in the foreign countries which compete with India.

(iii) It is hardly our business to advise Government on such aspects of affairs, but we suggest that where wide-spread smuggling is credibly understood to take place, it is probable that the duty is more than the goods or the consumer can reasonably stand, and that the advisability of downward revision should at least be examined.

(iv) No comments.

(v) No comments.

Question 105.—It the relative use of ad valorem and specific duties in the Indian Customs Tariff satisfactory? If not, in what respects would you enlarge or restrict the scope of application of either, whether used singly or in combination?

No comments.

Question 106.—(i) In what circumstances would you consider "tariff values" a satisfactory basis for assessment of import duties? (section 22 of the Sea Customs Act).

(ii) Are there any commodities to which you would extend the application of "tariff values"?

(iii) What change, if any, should be made in the procedure for determining "tariff values"?

We advocate fixation of tariff values only in cases of those commodities whose prices are fairly stable throughout the year.

Tariff values should be fixed in consultation with the trade and industry so that the possibilities of values fixed being out of parity with market prices, can be avoided.

Question 107.—(i) What changes in your opinion are necessary in the present provision (sec. 30 of the Sea Customs Act) regarding the determination of "real value" and why?

(ii) Would you suggest any specific measures to counter the evasion of import duties through deliberate under-valuation?

(iii) Have the methods of valuation in the Sea Customs Act proved satisfactory in relation to trade through the land customs border, especially on the Indo-Pakistan border? If not, have you any specific suggestions to make in this regard?

No comments.

Question 108.—What changes would you suggest in the matter of granting exemptions from, or reductions in, import duties especially in regard to:

- (1) raw materials used for essential industries;
- (2) materials used for scientific research;
- (3) materials imported for charitable and humanitarian purposes;
- (4) materials imported for stimulating desirable activities, such as agricultural development; and
- (5) necessities of life?

We are of the view that all the materials listed in the question should be exempt from duties. Plant and Machinery required by industry should also be excluded from the scope of the duty, but if assessed to duty, it should be the lowest.

Question 109.—To what extent do you think revenue might be sacrificed in the interests of bilateral or multilateral fiscal arrangements such as GATT or the preferences in favour of certain Commonwealth countries?

The Fiscal Commission considered this question, and were unable to make any estimate on account of the changing times. They, however, suggested that the general revenues may be sacrificed in the interests of the development of trade and economy of the country, if that was necessary. We are unable, however, to make any estimates, but we agree that the country should be prepared to make sacrifices in the interest of trade development.

Question 110.—Under what circumstances should customs duties be used in preference to import quotas as a means of restricting imports?

In our view, circumstances of each individual case should decide the issue as to whether customs duties or import quotas should be used as a means of restricting imports. As has been pointed out by us in our answer to question 104(i), the primary considerations which should govern the fixation of rates of duty are (a) revenue, and (b) protective. Where protective purpose is sought to be achieved, import quotas as a means of restricting imports of the protected commodity should be resorted to only when specifically recommended by the Tariff Commission after due enquiry, and that too only to the extent and for the period which may be recommended by the Commission. Where no such recommendation is made, Government should not resort to import control to ban imports as is being done at present in certain cases.

Question 111.—In what respects should the present law regarding "drawbacks" and "warehousing" be altered in order to assist the export trade in manufactured goods which involve the use of imported raw materials?

The present law regarding "drawback" should be extended to cover all exports of manufactured articles in which imported raw material was used.

Question 112.—Have you any suggestion to make regarding the administration of the Sea and Land Customs Acts, especially in regard to—

- (a) facilities for settlement of disputes arising out of appraisement;
- (b) penalties imposed under the Act and the appellate procedure relating to them?

The facilities at present provided for the settlement of disputes arising out of appraisement are not satisfactory. First, there is no statutory provision for the settlement of these disputes. Secondly, there is no right of appeal from an order of the Chief customs authority, but instead Government is vested with discretion under Section 191 of the Act. This state of affairs requires a thorough overhaul and we suggest that independent judicial machinery should be set up to deal with and settle

disputes. In this connection, it may be pointed out that Article X of the GATT to which India is a party lays down that judicial, arbitral or administrative tribunals should be set up for the purpose of the prompt review and correction of administrative action relating to customs matters.

Export Duties

Question 113.—Under what circumstances, in your opinion, should export duties be imposed?

This Association is opposed to the levy of export duties except either as an anti-inflationary measure or in order to retain essential materials in the country. Export duties which, in no case, should be imposed for revenue purposes should be most cautiously applied, and further, in order to prevent heavy and unexpected loss falling either on the exporter or the foreign buyer, exemption must be given to contracts placed before an export duty is applied or enhanced.

Nothing is more calculated to annoy foreign customers or to disrupt the course of export trade than the retrospective application of export duties, and the fear of such a possibility. It is equally detrimental to the handling of commodities by merchants and others whose business it is to carry stocks and generally assist in the marketing of production.

Question 114.—What measures would you suggest to achieve greater flexibility in the rates of duties to accord with the changing conditions of export markets?

Our experience has been that Government are not as prompt in withdrawing or reducing the duties as in imposing them. Instances are not lacking to show that Government's action has been belated and relief has come in only after the export trade has been seriously damaged by the duties in question. We would, therefore, suggest that when once a duty is imposed, Government must be vigilant in assessing the impact of the duty on the country's foreign trade by consulting the interests concerned, and should not hesitate to withdraw or reduce the duty as promptly as it was imposed.

Question 115.—Would you suggest that the whole or a part of the receipts from certain export duties should be funded for financing schemes for promoting long range development of the export trade, subject to the obligations under GATT?

We are opposed to the imposition of export duties as we have stated in reply to question 113. Where, however, such duties are imposed, we consider that the whole or part of receipts therefrom should be funded for financing schemes for promoting long range development of the export trade, provided they are exclusively used for the benefit of the trade concerned with the commodity on which the duty is imposed.

Question 116.—Would you, in the interests of revenue or from any other point of view, recommend increased participation by the State in import and export trade? If so, what form do you think should such participation take?

We would not recommend from any point of view any participation by Government in import and export trade, except in a national emergency.

CENTRAL EXCISES.

Question 117.—Do you regard as satisfactory the present selection of commodities for purposes of levying excise duties? If not, what changes would you suggest and why?

and

Question 118.—(i) Have you any changes to suggest in the present rates of excise duties?

(ii) Are the provisions regarding valuation satisfactory where ad valorem excise duties are levied?

It is appreciated that with the increasing self-sufficiency of the country, it is necessary to replace much of the revenue earlier derived from customs duty on imports by Excise on indigenous products and other commodities. Moreover, the delegation of this tax collecting to manufacturers or dealers is economical from the point of view of Government. The incidence of Excise on particular articles of commerce, however, is one that needs the most careful consideration and discriminate application. For instance, there is at present an excise duty on motor spirit and tyres. The duty is a burden on motor transport, and is, therefore, undesirable.

Similarly, the excise duty at present levied on steel ingots is a burden on the engineering industry as it is a raw material for that industry. We would, therefore, suggest that where a finished product forms the raw material for another industry, so far as the latter industry is concerned, the finished product should not bear any excise duty.

When the excise duty on fine and superfine cloth was originally conceived in December 1948, it was regarded

more as an anti-inflationary measure than anything else. Subsequently in 1949, the Finance Minister in his Budget Speech, in defending and extending the duty, referred to the need for finding revenue to offset the loss in revenue caused by the abolition of the Salt tax.

The position has since undergone a radical change: Firstly, the loss in revenue which fell to be made up was about Rs. 9 crores, which in the prevailing circumstances would have been met by an average duty of about half an anna per yard. Today, however, the duty is being adjusted and readjusted, to produce a revenue of about Rs. 16 crores, excluding the additional Rs. 5 crores which is sought to be raised to finance schemes for the development of the handloom industry. Secondly, the sellers' market which obtained when the duty was conceived, has since disappeared, and today there is strong consumer resistance, and fine and superfine goods are practically unsaleable except by manufacturers offering substantial discounts. This means that the duty comes from the pockets of the manufacturer, which was never intended to be the case, the assumption being that the excise duties would be borne by the consumer and the tax spread over the community.

We have in one of our earlier answers advocated each section of the community bearing an equitable share of the tax burden.

In the altered circumstances, we strongly urge that the excise duty on cloth be removed altogether, the loss in revenue being made good by other forms of taxation which will equitably fall on all shoulders rather than only on a particular section. In this connection, we have suggested the re-imposition of the salt tax.

Question 119.—Do you think that the differential rates of duty on different types of unmanufactured tobacco, other than flue-cured, should be replaced by a uniform rate of duty? Have you any other suggestions regarding the tobacco excise tariff?

Question 120.—Do you think that the lower rate of duty on the cottage match industry has been helpful to its development? If not would you suggest any change in the existing rates of duties?

Question 121.—Do you think that the arrangements for the assessment and collection of excises in respect of manufactured and unmanufactured commodities require simplification? In particular, please comment on the present system as regards—

- (a) licensing,
- (b) warehousing, and
- (c) transport of excisable commodities.

No comments.

Question 122.—Do you agree that a part of the proceeds of excise duties may be earmarked for expenditure on research and development schemes designed to improve the quality and marketability of the commodities?

Where excise duties already exist and are at a level which can reasonably be borne by the commodity, we agree that a part of the proceeds may be earmarked for research and development but only for the industry on whose manufactures the excise is collected. We are opposed to the imposition of any additional excise for such a purpose. We are also emphatically opposed to such an excise being collected on the products of one industry for the benefit of another.

Question 123.—Do you think that the imposition of excise duties has affected adversely the development of industries producing excisable commodities, e.g., their size and competitive capacity in export markets?

High rates of excise mean high prices and a resultant restriction of output and development. If this results in uneconomic units, it will affect the capacity to compete in export markets.

Salt Duty

Question 124.—Would you recommend the re-imposition of the excise duty on salt? If so, on what conditions?

We are in favour of the re-imposition of the salt duty.

Salt used for industrial purposes should not be subject to excise duty.

TAXES ON THE SALE OR PURCHASE OF GOODS AND ON ADVERTISEMENTS.

Question 125.—Under the Constitution, the only sales or purchases which can be taxed are sales or purchases of goods. Do you consider that the sales tax should be extended to—

- (i) services, so that the tax may be leviable on (a) charges for services proper (e.g., bills from a goldsmith or a printer), (b) charges for both services and goods where the two cannot be

readily separated (e.g., hotel bills) and (c) charges for certain types of goods into the price of which service enters as a substantial element (e.g., paintings or photographs); and

- (ii) transactions of sale or purchase in stock exchanges and futures markets?

If so, please deal with the administrative and other issues which may arise in the implementation of your suggestions.

(i) No.

- (ii) We are opposed to any further extension of the sales tax.

Question 126.—(i) The Union alone has the power to levy a tax on sale of newspapers or on advertisements in them. This power has not, so far, been exercised. Would you propose as desirable and feasible (a) a tax on sales only, or (b) a tax on advertisements only, or (c) a tax on both?

As regards (a), it has been urged that, on account of the small price charged for each newspaper, the sales tax would be fractional and cannot be passed on to the buyer, whereas in the aggregate it would be an undue burden on the concern itself. If you agree with this, how would you meet the difficulty?

As regards (b), what classes, if any, of newspapers or advertisements would you exempt from the tax, and what rates of tax, graded or other, would you levy?

- (ii) Have you any suggestions to make regarding the taxation of advertisements other than those appearing in newspapers?

Tax on sales of newspapers—We do not think it is desirable to levy a tax on sales of newspapers as we feel that reading of newspapers should be encouraged by keeping the cost of papers as low as possible.

Tax on advertisement in papers—We do not favour the imposition of any tax on advertisements in newspapers. A tax on advertisements might tend to discourage advertisement and thereby put up the cost of the paper to the reader. That apart, smaller papers would be driven out of existence.

Question 127.—As regards sales tax generally and, in particular, the sales tax on goods leviable by the States, it is sometimes argued that—since all goods sold in a State must fall within one of three categories, viz., (a) manufactured or produced within the State, (b) transported into the State from elsewhere in the country and (c) imported into the State from abroad—an extension or increase of excise would serve just as well as sales tax for category (a), of octroi or terminal tax for category (b), and of customs for category (c). Do you agree with this view which implies that the sales tax has no specific function to perform in the country's system of taxation? If not, what in your opinion, from the point of view of a correlated tax-structure, is the legitimate place and scope of the sales tax as distinguished from that of excise, octroi and customs?

Of the alternatives, we prefer the retention of the sales tax.

Question 128.—(a) Sales tax is almost invariably levied by the State Governments in terms of the turnover of the dealer over a given period. Since a sales tax leviable on the individual transaction necessitates fairly elaborate accounts, cash memos, etc., which only a small proportion of dealers is equipped to maintain, do you agree with the view that, in Indian conditions, the bulk of the sales tax is likely, for a long time to come, to continue to be leviable on aggregate turnover as distinguished from the individual sale-price?

(b) In most States there are separate laws governing sales tax on petrol. To what articles, if any, do you consider it desirable and feasible to extend the particular system adopted in respect of petrol?

(a) Yes, we agree.

(b) No comments.

Question 129.—(1) In regard to a system of levy based on turnover, is the choice broadly limited to the alternatives hereafter mentioned or is there any other system you would advocate? Under the system you recommend would the sales tax continue to be roughly as significant a source of State revenue as at present? The alternatives referred to above are:

(i) a relatively low rate of levy at each of almost all points of sale; few dealers excluded and few goods exempted (Multi-point);

(ii) a relatively high rate of levy at only one point, viz., the point at which a registered dealer sells either to a consumer or to an unregistered dealer; exemption from tax of sales by one registered dealer to another registered dealer; exclusion from compulsory registration of a

dealer below a certain limit of turnover; a large number of exempted goods (Single Point);

- (iii) various combinations of the above.

(2) Which of the above alternatives would you advocate? Please state your reasons in some detail, comparing merits and demerits from the point of view of (a) the consumer, (b) the dealer, (c) industry, trade, etc., generally and (d) Government. Please relate your arguments, as far as possible, to lessons which may be drawn from the actual working of Sales tax Acts in different States.

- (3) In particular:

(i) as regards (a) above, do you think that the sales tax or any particular form of it, leads to a greater burden being placed on the consumer than is accounted for by the proceeds which accrue to the Exchequer?

(ii) as regards (b) above, have you any suggestions to make regarding the simplification of forms, accounts etc., and of the procedure generally in order to make the administration of the tax less burdensome to the dealer? Further, having regard to the cost of maintenance of the machinery for compliance, would you suggest an alternative form of taxation so far as small dealers are concerned?

(iii) as regards (c) above, has the imposition of the sales tax led to any noticeable change in the organisation of the trade in the country, especially in regard to the size of the business unit, location of head-offices, number of intermediaries, variety of the goods dealt with, etc.?

(iv) as regards (d) above, please examine the financial and administrative aspects, including the scope for evasion presented by the particular system and the difficulty or otherwise of countering it.

(1) & (2). We prefer a single-point sales tax referred to in (ii) above. The recent experience in Bombay has shown that the single-point system of taxation is easier to administer and understand. We suggest that the single-point levy of tax should be at the last point of sale.

3(i). If we understand the question correctly, we think that there are fewer opportunities for misappropriation under the single-point system than any other.

(ii) In order to make the administration of the tax less burdensome to the dealer, we agree that the forms and accounts should be simplified, and assessments expedited, and there should be a time limit for the completion of the proceedings from the date of submission of the return by the assessee.

(iii) The only change of which we have any knowledge is the change in the number of intermediaries due to the introduction of multi-point sales tax.

(iv) In our view, evasion of tax could be substantially reduced, if not eradicated, by introducing the system of licensing of dealers which was in force in Bombay under the single-point system of tax.

Question 130.—In relation to the particular system you advocate:

(i) should there be special rates of levy, higher than the ordinary rate, for certain articles? If so, for which type of articles?

(ii) should there be special rates of levy, lower than the ordinary rate, for certain articles? If so, for which type of articles?

(iii) which articles, if any, should be exempted altogether and why? Please elaborate the principles which, in your opinion, should underlie exemption.

(i) & (ii) We have no objection to a rate higher than the ordinary rate of tax being imposed on luxury goods provided what constitutes "luxury goods" is reasonably defined.

(iii) Raw materials should be exempted from the tax in order to encourage industries and to avoid double taxation. Essential goods (vide items enumerated under the Essential Goods Declaration and Regulation of Tax on Sale or Purchase Act, 1952) should also be exempted from tax in order to make these essential goods available to the people at reasonable prices.

Question 131.—In regard to system, rates, exemptions, etc., what degree of uniformity between the different States do you consider desirable and feasible? Would you bring it about—

(i) by formal or informal convention;

(ii) by central legislation promoted at the instance of two or more States;

(iii) by constitutional amendment, so as to include certain basic matters connected with the sales tax in the Concurrent List?

- (iv) by constitutional amendment so as to include the item of sales tax, as a whole, in the Union List? In the last-mentioned case how would you apportion the proceeds? Would this alternative be a practicable proposition from the point of view of the finances of the States?

We prefer the inclusion of the item of sales tax as a whole in the Union List, the Central Government distributing the proceeds of the tax to the respective States. In our opinion, whatever sales tax is collected within a particular State by the Centre should be returned to that State.

Question 132.—To what extent has any desirable uniformity been achieved in regard to exemptions (in favour of "goods essential for the life of the community") under Clause (3) of Article 286 of the Constitution? What principles would you advocate for deciding the exemptions to be made under this provision of the Constitution? Do you consider that the scope of the provision contained in Clause (3) of Article 286 should be extended also to "essential articles" which had been subject to sales tax before the relevant central enactment came into force?

So far as our information goes, we do not consider that any desirable uniformity has been achieved in regard to exemptions of goods essential for the life of the community envisaged in clause 3 of Article 286 of the Constitution.

The principle to be followed in deciding the list of exemptions to be made under the Constitutional provision referred to above is—

- (a) whether it is required by the citizen in order to maintain himself; and
- (b) is it a raw material used by an Indian industry.

Our answer to the third part of the question is in the affirmative. The Central enactment in question should be made retrospective.

Question 133.—As regards "sales outside the State", "inter-State commerce", etc., please discuss the adequacy or otherwise of the relevant provisions of Article 286 and suggest remedies for any defects which, in your opinion, have been revealed in the actual working of these provisions.

- (b) Please discuss in this connection the desirability and feasibility of the suggestion that purchases only (and not sales) should be taxed, so that the tax jurisdiction of each State might be confined to parties residing within the State. Alternatively, do you consider that purchases should be taxed in certain cases and sales in certain others; if so, how, and on what considerations would you define the two categories? In either case, please describe your scheme in some detail and explain the advantages which you claim for it.

If our suggestion in answer to question 131 is adopted, this point would not arise. If, however, our suggestion is not adopted, then we suggest that the tax jurisdiction of each State should be confined to the dealers residing in that particular State. The obvious advantage in so restricting the jurisdiction is that trade and industry would now exactly where they stand under the law and what their tax liability is.

There should be no sales or purchase tax on inter-State transactions.

Question 134.—Do you think that lack of uniformity between the States as regards the rates of sales tax and the methods of applying it (single or multiple point) has the effect of raising barriers in inter-State commerce or of inducing uneconomic diversions of trade? If so, what measures would you suggest to rectify the position?

We do consider that lack of uniformity between the States as regards the rates of sales tax and the method of applying it has the effect of raising barriers in inter-State trade or commerce. Worse still, we consider that the narrow selfish uses, to which sales tax lends itself in the hands of individual States, are liable to lead to economic provincialism of a kind disruptive of the unity of the country and detrimental to its prosperity. We would, therefore, suggest centralisation of sales tax as pointed out in our answer to Question 131.

STATE EXCISES

Question 135.—(a) In regard to State Excise duties and the revenue therefrom, have you any comments or suggestions to make—

- (i) on features of importance connected with the system of levy of these duties in different States,

or

- (ii) on policies involving various degrees of relinquishment in certain States of the revenue from these duties?

Should there, in this context, be uniformity between different States? If so, in what particulars and to what extent?

- (b) Is there proper co-ordination between the levy of Central Excise on medicinal and toilet preparations containing alcohol, etc., and of State excise on alcoholic liquors? If not, what steps would you suggest to ensure adequate co-ordination?

No comments.

GENERAL

Question 136.—Do you think there is a case for vesting in the administration the power to alter, by executive order, the rates of import duties, export duties and excise duties? If so, please indicate in what circumstances and within what limits such power should be exercised?

No.

Question 137.—Do you visualise any scope for extension of the field of commodity taxation as a result of the implementation of the Five Year Plan?

and

Question 138.—What "luxury articles", if any, would you suggest on which commodity taxes in any of the various forms might be levied at specially high rates?

No comments.

PART IV—AGRICULTURAL INCOME-TAX, LAND REVENUE & IRRIGATION RATES

Agricultural Income tax.

Questions 139—142.—As we have stated elsewhere, we favour the collection of more taxes from agricultural classes, but we feel we are not competent to answer the questions in detail.

Land Revenue and Land Cesses.

Questions 143, 144, 145, 146, 147, 148.—No comments.

Question 149.—Do you think that the principles of assessment of land revenue will require modification if co-operative farming is more widely adopted? If so, in what directions?

We do not think that the principles of assessment of land revenue require modification, but as an incentive to co-operative farming, some concession may be offered.

Question 150.—Have you any comments to make on policies in respect of—

- (i) alienation of land revenue in forms in which such alienation subsists and may continue to subsist (e.g. devasthan inams);
- (ii) concessions in land revenue, both ad hoc and regulated, e.g., on (a) sale of land belonging to or at the disposal of Government or (b) transfer of such land either on special tenure such as impartible or inalienable tenure or on ordinary tenure to special classes of lessees such as educational or charitable institutions and co-operative societies; and
- (iii) suspensions and remissions?

No comments.

Question 151.—Are there any suggestions which you would make in regard to the assessment of—

- (i) agricultural land in rural areas, used for non-agricultural purposes;
- (ii) land classed as agricultural but now part of an urban area and used for non-agricultural purposes; and
- (iii) land classed as non-agricultural, whether in rural areas or in urban areas, and used for non-agricultural purposes?

We consider that the present principles properly applied are satisfactory.

Questions 152, 153, 154.—No comments.

Irrigation Rates and Betterment Levy.

Question 155.—Would you recommend any of the following taxes, either singly or in combination, where a major irrigation work has been constructed by the State—

- (i) a betterment levy representing a portion of the increase in the value of land;
- (ii) an irrigation rate for the water actually supplied;
- (iii) a smaller compulsory cess for all lands under command, whether the water is actually utilised or not;
- (iv) any other tax or taxes, as an alternative to or in conjunction with the above?

(i) We are opposed to a betterment levy, because it appears to be a form of capital gains tax. We suggest instead of a betterment levy, a surcharge on land

revenue until the next land revenue settlement becomes due.

(ii), (iii) and (iv)—We are in favour of an irrigation rate on water actually supplied and a small compulsory cess for all land under command, but we would not recommend any other tax.

Question 156.—What portion of the increment in land value may be reasonably absorbed by the State as betterment levy?

How should it be assessed, in what instalments should it be collected and by what administrative machinery?

How would you time the recovery in relation to development, i.e., before the project comes into full operation or afterwards when substantial incremental value is actually realised?

Would it be proper and practicable to impose a betterment levy on lands already benefited by an existing irrigation work?

Should the proceeds from the levy be earmarked for a specific connected purpose, e.g., contributing towards the cost of the particular irrigation project or of other irrigation projects?

In view of our answers to question 155, this question does not arise.

Question 157.—(i) Should the irrigation rate be no more than an adequate charge for the water supplied or should it also contain an element of additional levy on the increased yield or crops? Can you indicate with reference to conditions in your State whether, and if so to what extent, there is an element of additional levy in respect of (a) old irrigation works (b) new irrigation works? What limits would you place on the quantum of additional levy in respect of (a) old irrigation works, (b) new irrigation works?

(ii) Would you base the irrigation rate primarily on (a) area irrigated, (b) quantity of water supplied, (c) crop value, (d) any other factor?

(iii) Are you in favour of periodical revision of water rates? If so, with reference to one or more specified States, what period would you consider appropriate in conformity with economic considerations and in the light of administrative convenience?

(iv) Do you advocate concessional or incentive rates, particularly in the initial stages of development, with a view to encouraging the production of specific crops or the adoption of desired farming techniques?

We consider the irrigation rate should be no more than an adequate charge for water supply.

Question 158.—How would you fix the compulsory irrigation cess? Would you make it a small fee relatable to the annual cost of maintenance of the work?

We would make the irrigation cess a small fee relatable to the annual cost of maintenance of the work.

Question 159.—If the items mentioned above—betterment levy, irrigation rate and irrigation cess—were discussed in connection with a minor irrigation work, or a tube well scheme, to what extent would your replies have to be modified?

A lot depends on the extent of the benefits conferred by the works.

Question 160.—In what circumstances would a consolidated rate of land revenue—where the assessment includes an element of water rate—be preferable to a Scheme of separate irrigation rates and cesses?

In our opinion, separate rates would be better, because irrigation rates can be changed at more frequent intervals, but not land revenue, which according to our information is guaranteed for a certain number of years.

Question 161.—What is the scope for the imposition of a surcharge on irrigation rates based on—

(i) crop values;

(ii) sizes of holdings, etc.,

for the purpose of financing projects of a local character?

No comments.

PART V—OTHER TAXES (CENTRAL AND STATES)

Stamp Duties and Court Fees.

Question 162.—Under the Constitution—

(1) the Union is empowered to fix the rates of stamp duties in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts, and

(2) the States are empowered to fix the rates of all other stamp duties.

As regards both (1) and (2), have you any suggestions to make for the levy of a stamp duty where it is not already levied, or for an increase or decrease of the present rates where a stamp duty already exists? Please give reasons for your suggestions. Are there

any general principles which you would propose for adoption in regard to the fixation of rates of stamp duties?

As regards (2), since the rates vary from State to State, what degree of uniformity do you consider desirable and feasible, and how do you propose to achieve it?

If possible, please estimate the net effect of your proposals on the revenues of States.

Generally speaking, we consider the present rates of stamp duty on commercial documents sufficiently high. In particular, it is open to consideration whether the rates on usance bills of exchange should not be cut in the interests of export promotion.

As regards uniformity, we very definitely feel that these duties, in the interests of equitability and simplicity, should be as uniform as possible throughout India.

Question 163.—Certain States (e.g., Bombay) levy stamp duties on transactions in forward markets. What is your view regarding the complaint that the duties have tended to affect the business in the markets, particularly that of the middle-class traders? If you consider that the levy of stamp duty on transactions in these markets is a suitable and potentially important of securing revenue, what administrative and other measures would you suggest for the efficient collection of such duties. Alternatively, in place of stamp duties, would you suggest some other form of taxation of transactions in stock exchanges and future markets? If so, please elaborate your suggestion.

All genuine forward transactions either contemplate actual delivery, or are used in order to minimise market risk, that is, they are anti-speculative. In the former case, they are effected on delivery by sales tax, or in the case of stock Exchange Securities by stamp duty on transfers. In the latter, the availability of a properly conducted hedge contract to the trade and frequently to industry, is indispensable. Any further attempt to tax forward transactions will tend to drive trading underground with resulting deterioration in the trading conditions and morality, increase in speculation, and probably some loss of existing revenue to Government, let alone the prospect of any accession.

Question 164.—In this country, the stamp duty is ordinarily a tax on documents which constitute evidence of legal rights. There are, however, certain taxes, such as the entertainments tax, which are sometimes collected in the form of stamps, and suggestions have been made that this system may be appropriately extended to the collection of taxes on the sale of goods or on other transactions. Do you agree with this view? If so, to what taxes would you extend the scheme?

As the question states, stamp duties are in essence imposed on documents evidencing legal rights, and this imposition itself confers evidence of legality. Logically, their use can be and is extended to documents which grant rights other than strictly legal ones, e.g., tickets for admission to places of entertainment. It would be no less logical to levy a stamp duty on railway tickets or rail receipts and Government might possibly care to consider this, since it seems certain to us that any further increase in taxation will have to be as wide spread as possible. But any attempt to levy stamp duty on transactions which need not be documented will merely, in our view, lead to widespread evasion.

Question 165.—What are the more common methods of evasion or avoidance of payment of stamp duty? What means of prevention would you suggest?

No comments.

Question 166.—The rates of Court Fees differ from State to State. To what extent do you consider uniformity in the rates desirable and feasible?

We consider uniformity in this, as in any other form of tax which is of general application, desirable and administratively feasible.

Question 167.—Have you any suggestions to make regarding the Schedules to the Indian Court Fees Act and the rates of levy thereunder?

No comments.

Taxes on Motor and Other Vehicles.

Question 168.—Taking into account (a) the several taxes Central, State and Local, which affect motor transport directly and business, trades, etc., indirectly, (b) the variation in some of these taxes from region to region and between different categories of vehicles, and (c) the relative financial needs of the different taxing authorities, both generally and, in particular, for the maintenance, improvement and extension of roads, what changes, if any, would you introduce in the present system of motor vehicles taxation? What degree of uniformity do your suggestions involve? Instead of several taxes by different authorities, a consolidated tax has been suggested

ed: do you consider this feasible? How would you apportion the proceeds among the different authorities concerned?

In the interest of uniformity of taxation throughout the Union, we would prefer to see the centralisation of all motor taxes, duties, etc., but in view of the varying sources of taxation it is not possible to replace the existing taxes, duties, etc., with a consolidated lump sum duty. The position, however, appears to be capable of being met by the Centre prescribing a reasonable scale of duties and taxes which should be levied throughout India on motor vehicles, component parts, tyres, petrol, etc., etc., including charges of registration. All Municipal taxes, or other imposts on motor vehicles should be abolished, and each State should only be allowed to impose taxes strictly according to the scale drawn up by the Centre.

Question 169.—To what extent and in what manner, in your view, should the proceeds from motor vehicles taxation be earmarked for road maintenance and development?

In considering the question of apportioning or earmarking the proceeds for various purposes, the simplest procedure to adopt would be to reserve the amount collected by the levy of a reasonable scale of import duty on motor cars, spare parts and tyres, to the Centre for revenue purposes, and divide the balance to the various States according to the road mileage available in each State for road development and maintenance. If this basis of distribution to the States is not feasible, then it might be on the basis of petrol consumption in each administrative unit, except in the case of under-developed areas, where some concessional treatment might be required.

Question 170.—Have you any specific comments to make on the main recommendations of the Motor Vehicles Taxation Enquiry Committee, 1950?

Question 171.—Have you any suggestions to make regarding the extension of taxation to, or increase of present taxation on, users of roads other than motor vehicles? How would you classify the users, what rates would you suggest and who, in your view, should be the taxing authorities? How would you dispose of the proceeds?

We are generally in agreement with the observations and conclusions of the Motor Vehicle Taxation Enquiry Committee, and in particular we consider there should be no objection to a minimum tax of Rs. 60 per annum on urban and mofussil bullock carts, with a somewhat lower rate for pneumatic tyre fitted vehicles, and a cess of one anna on land revenue to represent a tax on rural carts, such taxes being collected by the States and passed on to the Centre to be credited to the Central Road Fund.

Entertainments Tax.

Question 172, 173, 174, 175.—No comments.

Tax on the Consumption or Sale of Electricity.

Question 176.—A tax on the consumption or sale of electricity is levied in several States in India. Do you consider that this is a suitable tax and may be adopted by other States? Would you restrict it to consumers of energy for domestic purposes or would you extend it to sales for industrial uses also?

A tax on electricity is a tax on progress, and as such will retard the raising of living standards on which the ready availability of electric service greatly depends. If the electricity tax cannot be removed, it should be minimised, but electricity required for industrial purposes should certainly not be taxed.

Question 177.—In respect of domestic purposes—

(a) should a distinction be drawn between the electrical energy consumed for lights and fans and the energy consumed for other domestic purposes (frigidaires, heaters, radios, etc.)? On what principles would you determine the rates of duty?

(b) what exemptions would you suggest and on what basis? Would you apply a lower rate of duty to small consumers?

No comments.

Question 178.—If you are in favour of a duty on energy used for industrial purposes, on what principles would you determine the rates of duty? What exemptions would you provide for and on what basis?

We are not in favour of a duty on energy used for industrial purposes.

Question 179.—How would you modify your suggestions in reply to the foregoing questions if electrical energy—

(i) is entirely supplied by Government undertakings in a State.

(ii) is supplied by Government undertakings in some areas of a State and private undertakings in other areas?

(i) and (ii) If a State Government undertaking supply electrical energy in a State, they should be subject to the same rules and regulations, restrictions, control, duties, etc., etc., as private undertakings, and their profits should be subject to income-tax and super-tax. In fact, they should be treated in every respect in the same way as private undertakings.

Question 180.—What degree of uniformity as between different States would be desirable in regard to the levy of electricity duty? How would you achieve it?

In our opinion, uniformity of taxation throughout the Union would be desirable, and this, in our view, can be achieved only if the power to impose a duty on electricity consumed were reserved for the Centre.

Betting and Prize Competition Taxes.

Questions 181, 182, 183.—No comments.

Question 184.—Have you any comments or suggestions regarding any other taxes, cesses or fees (e.g., excise on opium, probate and succession duties, registration fees) not covered by Parts II to V of the questionnaire?

No comments.

PART VI—LOCAL TAXATION.

Questions 185, 186, 187, 188, 189, 190, 191, 192, 193, 194.—No comments.

Question 195.—(a) Is there, in your opinion, defective co-ordination—fiscal, administrative or other—between particular local taxes and allied State or Central taxes? Please give instances and point out the nature and order of the detrimental effect, if any, on the public or on trade, industry, etc. What remedies would you suggest?

(b) Does the lack of co-ordination, in any particular instance, result in unnecessary duplication of staff or other forms of wasteful administration? Does it lead to needless harassment of the tax-payer by different tax-agencies? What remedies would you suggest?

There is little co-ordination between the States and local bodies such as municipal corporations, etc., in respect of matters concerning taxation, and each authority collects taxes according to its own requirements. This results in a certain amount of disparity especially where trade and industry are concerned, in view of the fact that industry located in a centre subject to high rates of municipal and state taxation is at a disadvantage when competing with the same industry situated in centres not so highly taxed. For instance, the municipal bodies situated in two adjoining centres like Bombay and Thana do not levy the same rate of tax, nor follow the same principles for assessment. Neither do they adopt the same articles or the same rate for purposes of octroi or town duties. We would suggest greater co-ordination between the States and the local authorities in taxation matters to ensure uniformity.

Question 196.—Apart from defects traceable to the Constitution (Question 186) or to the legal and other arrangements for devolution in individual States (Questions 188 to 194) or to inadequate co-ordination between the different tax-structures, Central, State and Local (Question 195), are there any other important types of defects in the framework of the system? Please give instances, What remedies would you suggest?

Please see our answer to Question 195.

Questions 197, 198, 199.—No comments.

Question 200.—Since (a) lands under non-agricultural use, (b) buildings and (c) income from both these are subject to taxation by:

(1) the Union—(Section 9 of the Income-tax Act),

(2) the States—(non-agricultural assessment and, in some States, urban immovable property tax and

(3) Local Bodies,

it is sometimes contended that there is multiple taxation of the same source of income and that, in any case, there is need for correlating those different taxes into a more rational system. Do you agree with this view? If so, what scheme would you suggest for the purpose? Would you adopt a uniform basis of valuation for all the taxes concerned, Central, State and Local? What basis would you adopt: the capital value of the property or its annual rental value?

We would favour a uniform basis of property valuation for purposes of taxation whether it be Central State or Local. In fixing the rental value for purposes of

such taxation, due regard should be had to all taxes, repairs and other outgoings of property owners, including cost of rent collection, depreciation, etc.

Question 201.—If the question of valuation was confined to the levy of urban immovable property tax by States and general property tax by Local bodies, what basis would you adopt: capital value or annual rental value? Do you agree with the recommendation of the Local Finance Enquiry Committee that "there should be no change from the well-tryed basis of rent to the more or less uncertain basis of capital value", but that where "municipalities are actually adopting capital value as the basis and there is no complaint, that basis may continue"?

If by capital valuation is meant the original cost of the property, then we submit that such valuation would yield different capital values for different properties according to the year in which they were erected, although the rents or returns may be more or less the same. In the circumstances, the rental value basis seems to be more acceptable, provided that in the case of industrial tenements the rent is not fixed only on the profits of the industry.

Question 202.—As regards the urban immovable property tax, the Local Finance Enquiry Committee says in effect that, even though property tax generally should be left to be exploited by local bodies, it would be both expedient and suitable for the Government (i) to levy an urban immovable property tax when a municipality fails to levy a property tax in spite of a statutory obligation to do so or (ii) to continue to levy the tax when a municipality refuses to increase its property tax to the extent the State Government is prepared to reduce its urban immovable property tax. Do you agree with this view? Have you any other comments to make on the urban immovable property tax? If you consider it a suitable form of taxation for the States, what modifications, if any, would you suggest in regard to exemptions, rates of levy, mode of assessment and procedure for collection?

No comments.

Question 203.—What principles would you recommend for adoption in regard to the general property tax? Would you exempt rental values below a particular level? How would you deal with the properties of owner-occupiers or of charitable or educational trusts or of co-operative housing societies? What remissions, if any, would you give for vacancies? So far as new buildings are concerned, would you recommend exemption for the first few years after construction, with a view to encouraging house-building?

This question has been partly answered in Question 200. We would not exempt any property from liability to pay tax. In the case of owner-occupied properties or charitable or educational trust or co-operative housing societies, rateable value should be worked out on the basis of the annual rent received, less all the owners' outgoings including a provision for depreciation. Such a provision, in our opinion, might encourage co-operative or private building schemes.

Questions 204, 205, 206.—No comments.

Question 207.—In so far as certain taxes usually known as "service taxes"—e.g., water, lighting, drainage and conservancy taxes—are levied along with, and on the same basis as, the general property tax by certain local bodies, what suggestions, if any, would you make in regard to the rates of levy, collection, etc., of these taxes? Have you any comments to make regarding property and service taxes vis-a-vis port trust properties, railway properties, other properties of the Central Government and properties of State Governments?

Were service taxes are collected on the same basis as the general tax, i.e., where the service tax takes the form of a percentage of the rateable value, the tax charged must be related to the expenditure incurred by the Municipality in giving the service. In other words, the quantum of tax imposed should not be either less or more than the expenditure actually incurred by the Municipality in giving the service.

We do not see any reason why Port Trust properties, Railway properties, Central Government and other pro-

perties should be treated differently from private properties.

Questions 208 to 216.—No comments.

Question 217.—Should the "pilgrim tax" levied by certain local bodies be more widely adopted? Do you consider that a suitable form of taxation on the floating population in the bigger cities can be devised?

We are opposed to the imposition of a pilgrim tax. We consider the object in India should be to reduce the cost of travel.

Questions 218 to 221.—No comments.

Question 222.—Have you any suggestions to make regarding the levy of betterment of taxes by different categories or local bodies (e.g., by a municipality in connection with town improvement)?

Betterment taxes should be imposed only after it is decided in what proportion expenditure incurred on betterment should be shared between the State Government, the Municipality and the property owners. In our view, the expenditure should be incurred in equal shares between the three parties, and the total amount to be recovered from property owners should be spread over a fixed number of years.

Question 223.—Have you any comments or suggestion to make on any items of local taxation not covered by the foregoing questions?

Question 224.—Have you any general suggestions to make regarding the fuller utilisation of their tax resource by different categories of local bodies?

As the Association's experience is confined to the working of the Bombay Municipal Act, we make the following suggestions concerning the industry, in regard to the taxes imposed by the Bombay Municipality:—

(a) **WATER TAX:**

- (1) The levy of water tax should be strictly in relation to the expenditure incurred by the Municipality in providing the service. The Municipality are at present making a very considerable profit which, in our opinion, is wrong in principle as the supply of water is an essential service.
- (2) There should be no discrimination in the levy between consumer and consumer, and every body should be treated alike. At present some consumers are charged for water at a level which is even below the expenditure incurred by the Municipality and others are overcharged. Similarly, chawls owned by employers are charged for water tax at 14 annas per 1,000 gallons, as against 3-3/4 per cent. collected from private land lords in the same locality.

(b) **GENERAL TAX:**

- (1) We consider that in fixing the rateable values of industrial tenements, the Municipality should be assisted by an independent board of qualified assessors.
- (2) Further, all appeals against rateable value in respect of such industrial properties should be disposed of by the Chief Judge of the Small Causes Court, with the assistance of a board of qualified assessors.
- (3) We consider that the amenities provided by the employer in his mill premises, such as hospitals, dining rooms, canteens, rest houses, creches, etc., should be free from general tax.
- (4) Section 175 of the City of Bombay Municipal Act offers a refund of general tax to the extent of 66-2/3 per cent. of the amount of tax paid if the industry was closed for not less than sixty consecutive days. It appears that even though the mills remain closed for more than sixty days, no refund of general tax would be admissible so long as machinery continues to remain installed in the departments. This defect should be set right and refund of general tax should be allowed on proof of closure only.

Questions 225 to 228.—No comments.

SUPPLEMENTS TO THE REPLIES OF THE MILLOWNER'S ASSOCIATION.

Answer to Question 62.—As regards rates of depreciation in respect of buildings, we had suggested that the factory buildings should be rated at 7½ per cent. and non-factory buildings at 5 per cent. If this suggestion is not acceptable to the Commission, then we would suggest the continuation of the provisions of Section 10(2) of the Indian Income-tax Act, 1922 as it stands, with the proviso that in case of extensive alterations, the depreciation allowance should be 7½ per cent.

Answer to Question 73.—In our original memorandum, we had put forward certain proposals regarding assessment of income from properties within the framework of Section 9 of the Income-tax Act. Where, however, an employer provides housing for his labour, such houses should be assessed with the employers' business under Section 10.

Answer to Question 75.—We would like to add one more point to our reply to this question. It is this. I

should be made mandatory on Income-tax officers to revise the assessment of the assessee under Section 18A(1) of the Indian Income-tax Act, where it transpires that the income of the succeeding year results in a lower tax than the one on which the original notice of the Income-tax Department was based. The position at present is that the Income-tax officers are only giving effect to it under the third proviso to the aforesaid provision where the revision happens to be in their favour.

Answer to Question 98(v).—On item (v) of this question, we had put forward two suggestions, viz., the appellate machinery should be absolutely independent; and secondly, the powers of enhancement of taxes should

be taken away from the Appellate Assistant Commissioner as the same was at present vested in the Income-tax Commissioner. If, however, the Commission were to hold the view that the Appellate Assistant Commissioner should have the power to enhance, we plead that such powers should be limited only to items appealed against, and not to any other item.

Answer to Question 99.—We would like to add one more point to our reply to this question. It is this, namely, our experience has been that inordinate delays occur in securing refunds not only on original assessments but also in respect of any appeals which have been decided in favour of the assessee.

SUPPLEMENTARY INFORMATION SUPPLIED BY THE MILLOWNERS' ASSOCIATION, BOMBAY.

STATEMENT I.

Estimate of Handloom Cloth Production in the Country.

An estimation of production of handloom cloth in the country involves, in the first instance, an estimation of the "free" yarn available for consumption by the handloom industry. For arriving at this "free" yarn, the method employed by the Millowners' Association, Bombay, as far back as 1916 was, first, to work out the quantum of yarn consumed by mills on the basis of a ratio of 100 lbs. of yarn to 112 lbs. of cloth. To the figure thus arrived at, was added the quantity of mill-made yarn exported from the country, and the resultant figure was deducted from the total yarn production, and the balance represented the "free" yarn. This basis was subsequently adopted by the Indian Industrial Commission in its report submitted in 1918.

In his "Notes on the Indian Textile Industry with special reference to Hand Weaving" compiled in 1926, Mr. R. D. Bell assessed that 1 lb. of yarn would yield 4 yards of handloom cloth since the bulk of handloom production was coarse. In the case of mill-made cloth, he stated that 1 lb. of yarn would, on an average, give 4.78 yards of cloth, and that 1 lb. of mill-made cloth was equivalent to 4.27 yards.

Referring to Mr. Bell's calculations, the Tariff Board of 1932 observed that in view of the average yardage of mill-made cloth per 1 lb. of yarn being 4.5 for India as a whole, 5.2 for Ahmedabad and 4.7 for Bombay in 1931-32, the estimate of 4 yards per lb. of yarn for handloom cloth given by Mr. Bell was too high on an average, and the Board thought that the average yardage was nearer 3 than 4 since as much as 80 per cent. of cloth woven on handlooms was from yarn of coarse counts, viz., 20s. and below. In the case of mill-made cloth, the Board was inclined to agree to a ratio of 100 lbs. of yarn to 110 lbs. of cloth since production had gone finer.

The Fact Finding Committee which was appointed in 1941 to make a survey of the handloom industry vis-a-vis the mill industry, however, observed in its report that the finding of the 1932 Tariff Board to the effect that the bulk of the handloom production consisted of counts 20s. and below was even more true of the mill industry as well. In this Committee's view, a ratio of 110 lbs. of mill-made cloth to 100 lbs. of yarn was a more correct assumption for years subsequent to 1931-32 onwards, as mills had gone finer. Accordingly, in converting the weight of mill-made cloth into its yarn equivalent, this Committee adopted a ratio of 112 lbs. of cloth to 100 lbs. of yarn for the period 1900-01 to 1930-31 and a ratio of 110 lbs. of cloth to 100 lbs. yarn for the subsequent period. As regards the ratio between yardage of cloth and weight of cloth, the F. F. C. observed that the earlier ratio of 4.27 yards of cloth to 1 lb. of cloth was

good for the period 1900-01 to 1930-31, but not for subsequent period for which a ratio of 1 lb. of cloth to 4.78 yards of cloth was taken. The F. F. C. also worked out the relation between the yardage of cloth and the weight of yarn, by taking into consideration the ratios between the weight of cloth and the weight of yarn and the yardage of cloth and the weight of cloth. For the period up to 1930-31, it accepted a ratio of 1 lb. of yarn to 4.78 yards of cloth, and for the subsequent years, a ratio of 1 lb. of yarn to 5.26 yards.

For the handloom cloth, the F. F. C. found that the ratio was 1 lb. of yarn to 4.57 yards where cloth was woven out of mill-made yarn, but where it was woven out of hand-spun yarn, the ratio was placed at 1 lb. of yarn to 3 yards, and the average ratio at 1 lb. of yarn to 4.36 yards of cloth. As regards the relation between the weight of cloth and the weight of yarn, the F. F. C. worked out a ratio of 100 lbs. of yarn to 102 lbs. of cloth assuming that there would be a 3 per cent. loss in weight due to wastage in yarn and a 5 per cent. increase in weight of cloth on account of the addition of starch. On the basis of this ratio, one lb. of handloom cloth was considered to be equivalent to 4.48 yards.

According to the Fact Finding Committee, the annual consumption of Indian mill yarn for different purposes classified counts-wise on the basis of 1937-40 figures was as under:

Consumption of Indian mill yarn for different purposes classified according to counts (1937-40).
(In million lbs.)

Counts.	Production of mill yarn in India (Average)	Consumption of Indian mill yarn by hand-looms (Average)	Exports (Average)	Power-looms, Hosiery, miscellaneous, etc. (Average)	Balance consumed by mills.
1-10s.	128.5	46.8	3.9	5.7	72.12
11-20s.	581.4	98.5	17.4	25.6	439.91
21-30s.	321.5	70.2	9.7	14.3	227.3
31-40s.	161.4	47.0	4.8	7.1	102.5
Above 40s.	87.3	36.8	2.6	3.8	44.1
Total	1,280.1	299.3	38.3	56.5	886.0

Consumption of different types of cotton yarn by handloom industry according to counts was, according to this Committee, as under:

Consumption of different types of cotton yarn by the handloom industry according to counts.
(In million lbs.)

Counts	Total consumption of cotton yarn (excluding two-folds)	Consumption of hand-spun yarn	Consumption of imported yarn	Consumption of Indian mill yarn
1-10s.	71.71	24.74	.19	46.79
11-20s.	123.63	24.74	.38	98.50
21-30s.	70.48	..	.32	70.16
31-40s.	50.93	..	3.91	47.02
Above 40s.	42.57	..	5.73	36.84
Two-folds, etc.	..	..	22.65	..
TOTAL	359.32	49.48	33.18	299.31

Percentage distribution by counts of the consumption of cotton yarn by handlooms and mills was, according to this Committee, as indicated in the table below :

Percentage distribution by counts of the consumption of cotton yarn by handlooms and mills.

Counts	Mills	Handlooms
	Percentage	Percentage
1—10s.	8.1	20.0
11—20s.	49.6	34.4
21—30s.	25.7	19.6
31—40s.	11.6	14.2
Above 40s.	5.0	11.8
TOTAL	100.0	100.0

On the basis of the above table, the Fact Finding Committee made the following observation :

“The percentage distribution of the mills steeply rises in the range 11-30s, while in the case of handlooms, it is more evenly spread out. Thus, both in very low counts and in high counts, the proportion of handloom consumption of yarn is higher than that of mill consumption of yarn. Another interesting point which arises from the table is that below 20s. the mills produce 57.7 per cent. of their output, while the handlooms produce somewhat less, viz., 54.4 per cent. of their output.”

In connection with the percentage distribution by counts of the consumption of cotton yarn by handlooms,

it must be pointed out that the percentages in question are based on consumption of all types of cotton yarn, i.e., mill-yarn, imported cotton yarn and hand-spun yarn. If mill-made yarn alone is taken into consideration, then the percentages relative to count-groups are as given in the table set out hereunder :

Percentage distribution by counts of the consumption of mill-made cotton yarn by handlooms.

Counts	Handlooms (Percentage)
1—10s.	15.60
11—20s.	32.90
21—30s.	23.50
31—40s.	15.70
Above 40s.	12.30
TOTAL	100.00

An attempt is made in the following paragraphs to set forth the position regarding the character and composition of production since the submission of report by the Fact Finding Committee. In so doing, foreign cotton yarn, the import of which in the last three years has not been of any appreciable quantity and hand-spun have been left out of account.

The two tables set out below give the production of cotton yarn since 1938 classified by count-groups, for the periods 1941-47 and 1948-52.

Production of cotton yarn by Indian cotton mills classified count-groupwise : Period 1941-47.

COUNT-GROUP.

Year	1 to 10	11 to 20	21 to 30	31 to 40	Above 40	TOTAL
1938-40	127,728	564,630	321,029	160,772	86,437	1,260,596
(Average)	10.13%	44.80%	25.46%	12.75%	6.86%	100.00%
1941	144,865	770,636	328,248	170,420	104,071	1,518,240
1942	165,693	804,414	314,418	153,782	72,293	1,510,600
1943	164,608	885,998	369,752	165,008	79,913	1,665,279
1944	172,728	839,964	346,176	170,581	92,721	1,622,170
1945	188,428	848,561	340,156	158,113	84,396	1,619,654
1946	159,069	666,230	288,767	157,712	112,026	1,377,804
1947	135,504	618,952	254,559	153,583	140,295	1,302,893
(1941-47 Average)	10.65%	51.19%	21.12%	10.58%	6.46%	100.00%

Production of cotton yarn by Indian cotton mills count-groupwise : Period 1948-52.

COUNT-GROUP.

Year	1 to 10	11 to 20	21 to 30	31 to 40	Above 40	TOTAL
1938-40	127,728	564,630	321,029	160,772	86,437	1,260,596
(Average)						
1948	157,160	806,229	228,779	145,769	102,647	1,440,584
1949	128,591	690,284	217,752	139,292	121,700	1,317,619
1950	86,758	555,148	176,132	214,128	122,640	1,154,806
1951	87,753	614,210	224,120	218,299	131,377	1,275,759
1952	115,949	725,391	253,452	241,835	84,828	1,421,455
(1948-52 Average)	8.72%	51.30%	16.64%	14.82%	8.52%	100.00%

From the above tables, it will be observed that production in counts 1-10s. went up and was well maintained during war-time but fast declined since 1950. Similar was the position with regard to counts 21s. to 30s. which

started falling since 1946. The production of counts 11-20s. though fallen down from peak level of war-period is still above pre-war level. But in respect of production in counts 31-40s. and over 40s. there has

been a spectacular increase. This table, therefore, indicates that there has been a shift in production from coarse to fine, and this inference is further corroborated

by the following table which gives the set-up of cloth production since 1945 :

Production of cloth by Indian Mills during the period 1945-53.
(Category-wise.)
(Figures in thousand yards.)

Year	Coarse	Medium	Fine	Superfine	Total production
1945	3,895,334 83.09%		539,996 11.50%	252,259 5.41%	4,687,589
1946	925,508 23.12%	2,296,152 57.36%	520,284 13.00%	260,843 6.52%	4,002,787
1947	803,956 20.95%	2,103,449 54.82%	645,998 16.84%	283,716 7.39%	3,837,119
1948	794,529 18.42%	2,577,520 59.75%	601,514 13.95%	339,996 7.88%	4,313,559
1949	452,068 11.58%	2,309,169 59.15%	809,240 20.72%	333,726 8.55%	3,904,203
1950	421,819 11.51%	1,781,436 48.61%	1,200,453 32.75%	261,383 7.13%	3,665,091
1951	363,516 8.92%	2,089,858 51.05%	1,347,946 33.07%	283,866 6.96%	4,076,186
1952	503,585 10.95%	2,706,580 58.85%	1,193,720 25.96%	194,753 4.24%	4,598,638
1953 (10 months, January-October)	492,859 12.02%	2,612,866 63.73%	740,949 18.07%	253,174 6.18%	4,099,848

From this table, it is clear that production of coarse cloth had gone down from 23 per cent. in 1946 to 11 per cent. in 1952 while fine had gone up from 11.5 to 26 per cent. In this period, the medium was almost stationary while superfine had gone up with the exception of 1952. Since 1952, about 30 per cent. of production has been in finer varieties, while 59 per cent. in medium and 11 per cent. in coarse.

To ascertain whether there has been any change in the character of production of the handloom industry in comparison with the mill industry, the following tables which give an indication of the actual and also percentage distribution by count-groups of the consumption of cotton yarn by handlooms and mills in the periods 1945-47 and 1949-53 *vis-a-vis* the position indicated by the Fact Finding Committee for the period 1937-40, may serve an useful guide:

Distribution by count-groups of the consumption of cotton yarn (mill-made) by mills and handlooms in the period 1945-47.
(In thousand pounds.)

Count-groups	F. F. C. Figures 1937-40 (Average)		1945		1946		1947	
	Mills	H. Looms	Mills	H. Looms	Mills	H. Looms	Mills	H. Looms
1-10s.	72,120	46,800	74,655	62,042	62,532	72,727	53,659	61,712
11-20s.	439,940	98,500	624,078	110,094	492,016	113,603	439,070	116,673
21-40s.	329,800	117,200	334,984	113,786	305,542	97,680	286,439	86,828
Above 40s.	44,100	36,800	56,446	14,150	80,712	16,220	106,656	17,802
TOTAL	886,000	299,300	1,090,163	300,072	940,802	300,230	885,824	283,915

(Source : Textile Commissioner's CST—Bulletins.)

Distribution by count-groups of the consumption of cotton yarn (mill-made) by mills and handlooms in the period 1949-53.
(In thousand pounds.)

Count-groups	F. F. C. Figures 1937-40 (Average)		1949		1950		1951		1952		1953	
	Mills	H. Looms	Mills	H. Looms	Mills	H. Looms	Mills	H. Looms	Mills	H. Looms	Mills	H. Looms
1-10s.	72,120	46,800	54,566	66,014	38,426	30,963	45,477	27,039	53,457	50,039	48,880	47,762
11-20s.	439,940	98,500	497,176	124,650	424,127	75,243	477,833	76,951	563,462	106,395	501,478	91,823
21-40s.	329,800	117,200	270,920	75,044	274,746	65,556	313,985	80,657	357,786	95,782	287,841	76,800
Above 40s.	44,100	36,800	97,693	13,202	95,281	14,606	102,352	17,805	63,960	12,399	71,609	13,035
TOTAL	886,000	299,300	920,355	278,910	832,580	186,368	939,647	202,452	1,038,665	264,615	909,808	229,420

(Source : Textile Commissioner's CST—Bulletins.)

[NOTE.—In the above two tables, the figures relating to yarn made available to the handloom industry have been arrived at after providing for the requirements of non-handloom consumers, worked out on the basis suggested by the Fact Finding Committee.

Percentage distribution by count-groups of the consumption of cotton yarn (mill-made) by mills and handlooms. (Period : 1945-47.)

Count-groups	F. F. C. Finding 1937-40 (Annual average consumption)			1945		1946		1947	
	Mills	H. Looms		Mills	H. Looms	Mills	H. Looms	Mills	H. Looms
		Mill-made Yarn only	All Yarns						
	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)
1-10s.	8.10	15.64	20.00	6.85	20.68	6.35	24.22	6.06	21.81
11-20s.	49.60	32.91	34.40	57.25	36.69	52.29	37.84	49.57	41.22
21-40s.	37.30	39.16	33.80	30.72	37.92	32.48	32.54	32.33	30.68
Above 40s.	5.00	12.29	11.80	5.18	4.71	8.58	5.40	12.04	6.29
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Percentage distribution by count-groups of the consumption of cotton yarn (mill-made) by mills and handlooms. (Period : 1949-53.)

Count-groups	F. F. C. Finding 1937-40 (Annual average consumption)			1949		1950		1951		1952		1953	
	Mills	H. Looms		Mills	H. Looms	Mills	H. Looms	Mills	H. Looms	Mills	H. Looms	Mills	H. Looms
		Mill- made Yarn only	All Yarns										
(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)	(Per- centage)
1—10s.	8.10	15.64	20.00	5.93	23.67	4.61	16.61	4.84	13.35	5.15	18.92	5.37	20.82
11—20s.	49.60	32.91	34.40	54.00	44.69	50.94	40.37	50.85	18.01	54.25	40.20	55.12	40.03
21—40s.	37.30	39.16	33.80	29.45	26.91	33.01	35.18	33.42	49.84	34.45	36.19	31.64	33.47
Above 40s.	5.00	12.29	11.80	10.62	4.73	11.44	7.84	10.89	8.80	6.15	4.69	7.87	5.68
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

It will be observed from the above tables that the percentage distribution is rather erratic. This erratic movement was due to the fact that in the war-period production of the mill industry was geared to war-time needs, and in the subsequent period, it was entirely

dictated by the availability of cotton, as could be seen from the following table which shows that there has been a considerable rise in the consumption of foreign cotton since 1947 :

CONSUMPTION OF COTTON BY INDIAN MILLS.

(In bales of 400 lbs.)

Year (Cotton Year)	Indian Cotton	FOREIGN						TOTAL
		American	Egyptian	East African	Sudan	Pakistan	Sundries	
1938-39	3,151,065	98,288	129,014	..	..	..	352,862	580,164
1939-40	3,050,106	92,198	130,448	239,272	..	..	77,348	539,266
1940-41	3,617,147	60,982	138,724	238,582	..	..	132,934	571,222
1941-42	4,025,232	36,296	159,884	307,578	..	..	131,382	635,140
1942-43	4,306,831	1,651	159,483	167,151	114,138	..	22,099	464,522
1943-44	4,119,461	367	331,581	174,021	116,286	..	11,416	633,671

CONSUMPTION OF COTTON BY INDIAN MILLS—*contd.*

(In bales of 400 lbs.)

Year (Cotton Year)	Indian Cotton	FOREIGN						TOTAL
		American	Egyptian	East African	Sudan	Pakistan	Sundries	
1944-45	4,158,661	172	267,640	236,311	118,076	..	21,023	643,222
1945-46	3,871,022	11,024	237,125	207,597	106,270	..	42,634	604,650
1946-47	3,215,155	73,061	296,301	200,232	104,642	1,016,836	21,745	1,712,817
1947-48	3,573,207	26,463	305,697	195,315	88,870	723,216	7,871	1,347,432
1948-49	3,152,606	72,663	395,850	185,967	60,120	410,956	5,165	1,130,721
1949-50	2,569,529	216,560	403,082	281,503	30,482	203,442	5,642	1,140,711
1950-51	2,500,480	472,433	306,306	228,382	76,114	17,578	4,312	1,105,125
1951-52	2,942,022	694,547	157,524	162,868	63,216	4,185	1,678	1,084,018

The rise in the consumption of foreign cotton was due to the loss of Pakistan cotton for consumption in the Indian Mills. Furthermore, there was control on prices until recently and to certain extent the controlled price structure also had considerable influence on the character of production. In the period 1945-47, production of cloth by textile mills in counts above 35s. was 20 per cent. on an average, while 80 per cent. accounted for the production of cloth in counts below 35s. In the period 1950-52, production of cloth above 35s. went up to 36.7 per cent. while production in counts 35s. and below went down to 63.3 per cent. In other words, mills had gone considerably finer compared to the period covered by the survey of the Fact Finding Committee. Since the F. F. C. adopted a ratio of 100 lbs. of yarn to 110 lbs. of cloth for the period subsequent to 1931-32, it stands reason that the ratio should now be lesser

than 110 lbs. of cloth for every 100 lbs. of yarn. The point for consideration, however, is whether it is advisable to alter the ratio in the light of facts and figures pertaining to an extraordinary period during which the character of production was not determined by the normal forces of supply and demand.

To appreciate the trend of consumption of mill-made cotton yarn by the mill and the handloom sectors, the figures relating to the year-wise percentage distribution given in the two tables set out on page 8, have been reduced to averages, in the following table, for two distinct periods, i.e., the period 1945-47 representing the pre-partition period and the period 1949-53, representing the post-partition period, and the average position indicated by the Fact Finding Committee for the period 1937-40 has also been placed in juxtaposition for the purpose of comparison :

Count-groups	Mill Industry			Handloom Industry		
	1937-40	1945-47	1949-53	1937-40	1945-47	1949-53
	Percentage	Percentage	Percentage	Percentage	Percentage	Percentage
1-10s.	8.10	6.52	5.18	15.64	22.24	18.67
11-20s.	49.60	53.04	53.03	32.91	38.58	40.66
21-40s.	37.30	31.84	32.39	39.16	33.71	34.32
Over 40s.	5.00	8.60	9.40	12.29	5.47	6.35
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00

From this table, it will be seen that in production up to 20s., there has been no change in the case of mill industry whether in the period 1937-40 or 1945-47 or 1949-53, though there has been a shift in the production from 1-10s. to 11-20s. In the case of handloom industry, the position, however, is that the percentage consumption has gone up from 48.56 to 60.82 in the period 1945-47 and to 59.33 in the period 1949-53. In the counts 21-40s. there has been a reduction both in the mill industry as also in the handloom industry, but in the case of 40s. and above, consumption has increased in the case of mill industry but has decreased in the case

of handloom industry. In other words, the handloom industry has gone coarser and it is, therefore, a matter of doubt whether it is advisable to accept a ratio of 1 lb. of yarn : 4.57 yards of cloth suggested by the F. F. C.

Until such time a re-alignment takes place in the matter of production of cloth in both the sectors, it seems advisable to accept the F. F. C. ratio of 100 lbs. of yarn to 110 lbs. of cloth in the case of mill-made cloth and Mr. Bell's estimate of 1 lb. of yarn to 4 yards of handloom cloth. It is on this basis that an estimate of handloom production is given in the following table for the last 3 years, viz., 1950-52 :

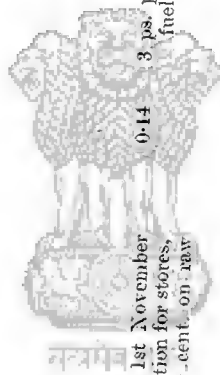
1	2	3	4	5	6	7	8	9	10
Year	Production of yarn	Production of cloth	Consumption of yarn by mills on the basis of 106 lbs. of yarn = 110 lbs. of cloth	Yarn surplus to the requirements of mills (Col. 2-Col. 4)	Yarn exported	"Free Yarn" (Col. 5-Col. 6)	Yarn consumed by powerlooms, hosiery, etc. (15% of "free yarn")	Yarn available for consumption by handlooms (Col. 7-Col. 8)	Handloom cloth production on the basis of 1 lb. of yarn = 4 yds. of cloth
	In thousand lbs.	In thousand lbs.	In thousand lbs.	In thousand lbs.	In thousand lbs.	In thousand lbs.	In thousand lbs.	In thousand lbs.	In thousand yds.
1950	1,154,806	857,302	779,365	375,441	82,700	292,741	43,911	248,830	995,320
1951	1,275,759	969,067	880,970	394,789	26,200	368,589	55,288	313,301	1,253,204
1952	1,421,455	1,053,823	958,021	463,434	19,800	443,634	66,545	377,089	1,508,356

STATEMENT No. II
A STATEMENT SHOWING THE TAXES AND DUTIES PAID BY THE COTTON MILL INDUSTRY OF BOMBAY CITY AND ISLAND.

	1951		1952		1953		REMARKS
	Rate of Duty	Total amount paid by Bombay Mills	Rate of Duty	Total amount paid by Bombay Mills	Rate of Duty	Total amount paid by Bombay Mills	
1. Import Duty on Raw Cotton	2 as. per lb. of cotton	1-92	2 as. per lb. for January and February 2 as. 1-1/5 ps. from March onwards.		1-96	2 as. 1-1/5 ps. per lb. of cotton.	Rs. in crores
2. Excise Duty	For rates please see Annexure II.	5-22	For rates please see Annexure II.		4-69	For rates, please see Annexure II.	Rs. in crores
3. Sales Tax on raw cotton, stores, fuel oil, etc.	Nil	Nil	Nil for 10 months. From 1st November 3 ps. per rupee per transaction for stores, fuel oil, etc., and 1 per cent. on raw cotton.		0-14	3 ps. per rupee per transaction for stores, fuel oil, etc., and 1 per cent. on raw cotton.	Rs. in crores
4. Import Duty on Furnace Oil.	Rs. 12 per ton	0-25	For January and February, Rs. 12 per ton. From March onwards Rs. 12-6 per ton.		0-26	Rs. 15-75 per ton	Rs. in crores
5. Electricity Duty.	1/8 anna per unit	0-39	1/8 anna per unit		0-36	1/8 anna per unit	Rs. in crores
6. Increase in wage bill over 1948 (excluding bonus).	....	0-09	....		2-17	....	Rs. in crores
7. Sales Tax on Cloth	....	2-94	....		3-18	....	Rs. in crores
TOTAL	....	10-81	....		12-76	....	Rs. in crores
Total Production		1-367 million yds.			1-422 million yds.		1,578 million yds.
Taxes, duties, etc., paid per yard		1-26 annas.			1-43 annas.		8 annas.

(From 26th November 1953, a drawback is allowed on exports of foreign cotton goods, but it is paid to the actual exporters).

(Additional Excise duty on dhuties imposed with effect from 26th October 1953, of which no estimate can be made.)



ANNEXURE I.

Notes on the statement relating to taxes and duties payable by the cotton mill industry of Bombay City and Island.

(1) Import Duty on Cotton.

In March 1952, the rate was changed from 2 as. per lb. to 2 as. 1-1/5 ps. per lb., by the Finance Act, which imposed a 5 per cent. surcharge on all import duties.

Please note that the amounts have been calculated, for 1951 on the consumption of raw cotton in the period September 1950 to August 1951; for 1952 on the consumption in the period September 1951 to August 1952; and for 1953 on the consumption in the period September 1952 to August 1953. The actual figures of consumption were:

1950-51	3,90,768 bales of 392 lbs.
1951-52	3,80,826 bales of 392 lbs.
1952-53	3,06,229 bales of 392 lbs.

(2) Excise Duty.

For rates of excise duty, please see Annexure II.

The amount has been estimated in the following manner. The actual loom state production of coarse, medium, fine and superfine cloth in each of the calendar years 1951, 1952 and 1953 was taken from which was subtracted half of the all-India exports of cotton textiles in each of these varieties, to allow for the exports from Bombay City mills. The total amounts were estimated with reference to the rates contained in Annexure II.

(3) Sales Tax.

The original single-point Sales Tax Act of the Government of Bombay provided for exemption from the tax in respect of raw materials, fuels, lubricants, stores, etc., purchased by industrial concerns for the purpose of manufacture. Hence there was no sales tax on these items in 1951 and in the first ten months of 1952.

The Government of Bombay brought their new multi-point Sales Tax Act into force with effect from 1st November 1952, and the new Act did away with the exemption for raw materials, etc., purchased by industrial concerns. An estimate is made in the following paragraphs of the addition to manufacturing charges brought about by the levy in the calendar year 1953.

Cotton.—Sales tax is levied at the rate of 1 per cent. on raw cotton. The tax, however, does not apply to imported cotton if the cotton is imported by mills themselves.

In 1952-53, the Bombay mills consumed 929,187 bales of Indian cotton. Taking the average price at Rs. 425 per bale (i.e., Rs. 850 per candy), the value of this cotton comes to Rs. 39.5 crores. The sales tax at 1 per cent. amounts to Rs. 39.5 lakhs.

The value of the total cotton consumption by Bombay mills in the year 1952-53 was roughly Rs. 72.5 crores. Subtracting Rs. 39.5 crores, the approximate value of the Indian cotton, the value of the foreign cotton consumed amounted to Rs. 33 crores. It is estimated that 85 per cent. of this foreign cotton was imported in the mills' own account, and the remaining 15 per cent. valued approximately at Rs. 5 crores was purchased through importers and had to bear the tax at 1 per cent. amounting to Rs. 5 lakhs.

The sales tax on cotton may, therefore, be taken to have been as under:—

1 per cent. on Indian cotton costing about Rs. 39.5 crores	Rs. 39.5 lakhs
1 per cent. on 15 per cent. of the total foreign cotton consumption, valued at about Rs. 33 crores	Rs. 5.0 lakhs
Total	Rs. 44.5 lakhs

Stores.—The actual consumption of stores by Bombay mills comes to about Rs. 10.5 crores. Stores have to bear the sales tax at three pies per rupee on every transaction. Assuming that, on an average, stores pass through two hands before reaching the mills, the tax will amount to 6 pies in the rupee, and on this basis, the tax on Rs. 10.5 crores amounts to Rs. 31.5 lakhs.

Furnace Oil.—As the furnace oil goes directly from the Oil Companies to the mills, it will bear the tax only once, at three pies in the rupee. The average ex-installation price of furnace oil for the year 1953 was Rs. 141-8-0 per ton. The actual consumption of furnace oil is about 204,000 tons, and the amount of sales tax payable on furnace oil comes to Rs. 4.5 lakhs.

The amount of sales tax borne by mills may, therefore, be calculated as under:

Sales Tax on Cotton	Rs. 44.5 lakhs
Sales Tax on Stores	Rs. 31.5 lakhs
Sales Tax on Furnace Oil	Rs. 4.5 lakhs
Total	Rs. 80.5 lakhs

The sales tax for the last two months of 1952 has been put down at one-sixth of the total sales tax estimated above for the year 1953.

(4) Import Duty on Furnace Oil.

The rate which was Rs. 12 per ton in 1951 went up to Rs. 12.6 from March 1952, because of the 5 per cent. surcharge imposed on all import duties in the Finance Act of 1952. It went up further to Rs. 15.75 in 1953 on account of an increase in the tariff value of furnace oil (from Rs. 80 per ton to Rs. 100 per ton).

(5) Electricity Duty.

The number of units consumed by the Bombay mills in each of the years 1951, 1952 and 1953 was as under:

1951	494.0 million units
1952	455.6 million units
1953	540.4 million units

The duty has been calculated at one-eighth anna per unit.

(6) Increase in Wage Bill.

In the Association's brochure "Cotton Mill Industry and Taxation", computations have been made to show how the burden on the cotton mill industry had increased since 1948. Hence we have put down figures showing the increase in wage bill over that of 1948. This includes basic wages, dearness allowance, leave with wages, paid festival holidays, contributions to the Employees' State Insurance Corporation, and the Provident Fund contributions. No account has been taken of the bonus which is assessed by the Tribunals on the basis of the profits. The total figures of wages were as under:

1948	Rs. 23.73 crores
1951	Rs. 23.82 crores
1952	Rs. 25.90 crores
1953	Rs. 32.07 crores

(7) Sales Tax on Cloth.

An attempt is made here to estimate the amount of sales tax borne by cloth produced by the mills in Bombay City and Island.

The amount of realisation by cloth sales came to Rs. 124.83 crores in 1951. From this must be subtracted the amount realised from exports as the exports do not bear any sales tax. In the year 1951, 780 million yards of cloth were exported from India, and 50 per cent. of it is estimated to have gone from Bombay mills. This gives a figure of 390 million yards for exports from Bombay mills. The total amount of cloth produced was 1,367 million yards, and taking *pro rata* price for exports, the balance realisation on cloth sold in India comes to Rs. 89.25 crores. This is the ex-mill price. The retail price is about 15 per cent. higher than the ex-mill price. Hence the retail value of the same cloth is obtained as Rs. 102.64 crores. Although the rate of tax in Bombay was 6 pies in the rupee, and was the same in several other States, there were a few States which did not charge any sales tax, and there were others which charged 3 pies in the rupee on every transaction. We have, therefore, taken 5.5 pies in the rupee as the average rate of tax borne by Bombay mills' cloth, wherever it was sold in India. The total amount on this basis comes to Rs. 2.94 crores for 1951.

Gradually sales tax was extended practically to all States. The rates were also put up in several States, and the single-point tax of Bombay and some other States which was applicable at the rate of 3 pies on every transaction also resulted in realising much more than 6 pies in the rupee on the types of cloth which were subject to such multi-point tax. We have, therefore, taken the progressively higher rates of 6 pies in the rupee for 1952 and 6.5 pies in the rupee for 1953.

The basic data for the calculation of the sales tax for all these years is summarised below:

	1951	1952	1953
	Rs.	Rs.	Rs.
Realisation by Cloth sales.	124.83	111.29	123.53 (Calculated <i>pro rata</i> on the average price realised in 1952).
	Million Yards	Million Yards	Million Yards
Total Cloth production	1,367	1,422	1,578
Exports from Bombay City Mills taken at half of All-India exports.	390	293	350
Average rate of sales tax borne by Bombay cloth sold anywhere in India.	5.55 pies in the rupee	6 pies in the rupee	6.5 pies in the rupee
			39 A

The various burdens referred to in the Association's brochure "Cotton Mill Industry and Taxation" had their full impact for a complete year in 1953, and it will be

observed that the additional cost averages 2-28 annas per yard.

ANNEXURE II.

RATES OF EXCISE DUTY ON CLOTH.

Rates of Excise Duty on Cloth				
	Coarse	Medium	Fine	Superfine
1-1-1949	Nil	Nil	Nil	25%
	Pies per yd.	Pies per yd.		
1-3-1949	3	3	4%	25%
1-2-1950	3	3	5%	20%
9-5-1952	3	3	Grey and Bleached in Group IX—7 pies or 50% whichever is less.	Grey and Bleached—3 as. or 20% whichever is less.
			Dyed and Printed in Group IX—9 pies or 50%.	Dyed and Printed—3½ as. or 20% whichever is less.
			Grey and Bleached of other Groups—11 pies or 5%.	
			Dyed and Printed of other Groups—12 pies or 5%.	
15-2-1953			Additional Excise Duty of 3 pies per yard on all mill cloth	
			Pies	Pies
28-2-1953			3	3
			3	15
			3	39
25-10-1953			3	3
			3	15
			3	27
26-10-1953			3	3
			Additional Excise Duty on Dhooties issued in excess of the quota of 60% of total Dhooties packed in basic period.	
Issues upto quota				Nil
Excess of 0% to 12½%				2 annas per yard
Excess of 12½% to 25%				3 annas per yard
Excess of 25% to 50%				4 annas per yard
Exceeding 50%				8 annas per yard

STATEMENT No. III.

Estimation of the receipts from the special duty levied to assist handlooms and khadi industries.

On page 5 of the Explanatory Memorandum on the Budget for 1953-54, the Government of India estimate that in the year 1953-54, the income from the new cess levied for the benefit of the handloom and khadi industries would be Rs. 6 crores. When the Association's representatives appeared before the Taxation Enquiry Commission, they were asked to check up and ascertain whether this estimate has been attained or exceeded.

We have accordingly applied ourselves to this limited objective, and in our calculations, we have utilised the following figures :—

The production of cloth for the first ten months of the year 1953-54, as estimated by the Textile Commissioner is 4,114 million yds.

Exports of cotton cloth in the same period, according to the statistics of the Export Trade Controller, is (in round figures) 646 million yds.

Exports do not attract the excise duty, and we have therefore deducted the second mentioned figure, namely, exports, from the first mentioned relating to production, and obtained a retained production of 3,468 million yds. for the first ten months of the year 1953-54.

Stores supplied to Government do not attract excise duty, and from the figures published by the Textile Commissioner, we find that in the first seven months of the year 1953-54 for which figures are available, 16,478

bales of cloth (one bale is approximately 1,500 yds.) were delivered "for other purposes", which we interpret to mean Government purposes including defence, railway, police, postal departments, etc.

The above figures we have utilised to arrive at the total quantity of cloth which would be retained in the country and which would attract the excise duty of three pies per yard. This total works out at 4,120 million yards per annum, which at three pies per yard, yields an excise duty of Rs. 6.44 crores, as against Government's estimate of Rs. 6 crores.

Before concluding this note, we shall be failing in our duty if we did not bring to the notice of the Commission, some of the snags in the method of estimation we have adopted. These are :—

(1) The production figures are compiled by the Textile Commissioner, whereas the export figures are compiled by the Export Trade Controller, the latter's export figures only representing goods passed out for shipment. There is a lag between "passed out for shipment", and "actual shipment", in the sense that all that is passed out for shipment need not have been shipped in the same period, but over a period, there should be no difference.

(2) We have assumed that deliveries of cloth for other purposes is entirely for military and other Government requirements, which requires confirmation.

(3) The rule of three which we have applied in estimating the total annual figures, assumes that the rate of export or the rate of deliveries for Government purposes would be maintained in the period for which no figures are available.

STATEMENT No. IV.
Average total emoluments of a cotton mill worker in
Bombay City.

The following table gives the average total emoluments of a worker in the cotton mill industry in Bombay City for the years 1951, 1952 and 1953 :

	1951	1952	1953
	Rs. A. P.	Rs. A. P.	Rs. A. P.
Average monthly basic wages (for 26 days).	47 2 0	49 2 6	49 2 6
Average monthly Dearness Allowance (for 26 days).	57 7 0	59 4 0	66 2 0
Leave with wages	1 10 0	3 6 6	5 8 8*
Paid Festival holidays	..	1 6 3	1 7 10
Employees' State Insurance.	..	0 10 10	0 13 9
Provident Fund Contribution.	..	1 2 10	7 10 0
	106 3 0	115 0 11	130 12 9
Base	(100-0)	(108-4)	(123-1)
Bonus	11 6 0	7 6 0	The demand for bonus has not been raised so far.
	117 9 0	122 7 0	

* Estimate of leave with wages for the year 1953.

1. Paid Festival Holidays.—Paid Festival Holidays were introduced from 22nd April 1952 by an Award. The Paid Festival Holidays are Holi (one day), Divali (one day), Mahatma Gandhi's Birthday (one day) and Independence Day (one day).

2. Employees' State Insurance.—A special contribution at the rate of $\frac{3}{4}\%$ of the total wage bill was imposed with effect from 24th February 1952. The commitments of 10 months from March to December 1952 have been divided by 12 to arrive at the average commitment per month of the year 1952.

3. Provident Fund Contribution.—Provident Fund was introduced under the Employees' Provident Fund Act, with effect from 1st November 1952. In this case also the contribution for the two months of November and December 1952 has been divided by 12 to arrive at the average contribution per month of the year.

It may be mentioned that the Industrial Court has awarded an increase of 10 per cent. in the dearness allowance with effect from June 1953. The Appeal filed by the Association in this regard is pending before the Labour Appellate Tribunal.

STATEMENT No. V.
Production of Cotton piecegoods (in thousands of yards) in Bombay City.
(LOOM STATE PRODUCTION.)

(Source : Textile Commissioner, Bombay.)

	Coarse	Medium	Fine	Superfine	TOTAL
1951-52					
April	9,952	40,593	52,395	11,827	114,767
May	9,178	50,903	40,882	12,876	113,839
June	9,725	53,247	39,797	12,647	115,416
July	9,724	54,059	40,207	10,171	114,161
August	10,206	57,945	43,021	10,369	121,541
September	9,538	51,859	41,699	9,238	112,334
October	9,213	54,186	37,080	8,913	109,392
November	8,507	52,932	28,827	7,028	97,294
December	9,329	57,424	29,283	7,693	103,729
January	10,282	56,093	33,690	7,262	107,327
February	9,210	54,361	32,868	6,772	103,211
March	9,118	55,843	32,236	7,213	104,410
TOTAL	113,982	639,445	451,985	112,009	1,317,421
	(8.65%)	(48.54%)	(34.31%)	(8.50%)	(100.0%)
1952-53					
April	9,319	58,095	30,408	6,765	104,587
May	10,078	62,565	33,585	7,635	113,863
June	14,720	58,147	32,271	6,760	111,898
July	20,219	65,118	37,288	7,151	129,776
August	18,472	68,462	36,982	7,476	131,392
September	16,586	65,465	36,492	7,658	126,201
October	17,977	62,597	37,278	7,282	125,132
November	20,307	65,531	32,184	8,444	126,466
December	21,247	75,354	28,364	9,651	134,616
January	18,919	78,137	25,264	11,019	133,339
February	16,222	69,914	23,633	9,238	119,007
March	18,065	71,361	26,270	10,178	125,874
TOTAL	202,131	800,746	380,019	99,257	1,482,151
	(13.64%)	(54.02%)	(25.64%)	(6.70%)	(100.0%)

STATEMENT No. V.

	Coarse	Medium	Fine	Superfine	TOTAL
<i>1953-54</i>					
April	21,242	75,745	26,464	11,558	135,009
May	19,123	78,340	24,631	12,363	134,457
June	18,409	78,115	22,725	12,007	131,256
July	19,270	82,971	23,445	12,260	137,946
August	19,647	83,257	23,413	12,931	139,248
September	17,354	77,429	17,638	11,854	124,275
TOTAL (April-September)	115,045	475,857	138,316	72,973	802,191
	(14.34%)	(59.32%)	(17.24%)	(9.10%)	(100.00%)

STATEMENT No. VI.

Mills in Bombay City and Island.

Stocks of Cloth as on the last day of each month (in full bales).

	1951											
	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
(a) Total physical stocks	50,301	52,814	68,670	88,559	101,478	111,947	100,558	103,119	111,129	106,911	91,253	89,756
(b) Quantity earmarked for export.	37,348	28,301	18,267	11,540	10,964	9,507	8,899	10,215	10,504	9,133	10,874	10,286
(c) Quantity earmarked for defence.	2,061	1,114	1,248	1,191	1,051	1,451	1,175	1,173	887	944	1,339	1,330
(d) Balance for civil consumption.	15,895	23,399	49,154	75,827	92,463	100,988	90,484	91,731	99,737	96,833	79,039	78,138
(e) Quantity paid for but delivery not taken.	5,550	6,024	10,304	15,590	27,121	20,890	18,317	18,297	18,723	17,303	15,479	13,425
(f) Balance awaiting disposal as under.	10,344	17,375	38,850	60,237	65,341	80,098	72,167	73,433	81,013	79,530	63,560	64,713
Coarse	791	1,672	6,039	4,645	4,334	4,784	5,567	5,359	5,483	6,890	4,681	5,090
Medium	3,302	5,239	12,106	19,113	24,974	33,095	34,883	33,697	34,871	37,934	34,146	36,363
Fine	3,720	6,144	15,230	26,547	27,454	31,553	24,129	25,426	31,186	26,245	17,827	17,099
Superfine	1,816	3,431	4,580	9,068	7,327	8,984	6,073	7,270	7,570	6,590	5,116	4,313
Fents	713	798	893	862	1,250	1,681	1,513	1,579	1,901	1,869	1,787	1,847
	1952											
	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
(a) Total physical stocks	93,975	103,738	124,715	112,778	92,596	82,775	81,558	80,147	91,469	95,372	116,356	122,503
(b) Quantity earmarked for export.	11,241	10,813	10,089	10,870	12,573	15,139	19,716	16,834	16,824	320	22,205	17,309
(c) Quantity earmarked for defence.	1,678	1,197	1,406	1,015	957	896	1,126	1,056	1,213	994	1,035	1,480
(d) Balance for civil consumption.	81,056	91,727	113,219	100,893	79,065	66,739	60,716	62,257	73,432	77,058	93,116	103,714
(e) Quantity paid for but delivery not taken.	12,511	14,813	4,133	9,721	9,040	10,403	8,886	10,200	8,649	7,259	7,719	12,516
(f) Balance awaiting disposal as under.	68,544	76,914	109,085	91,172	70,025	56,336	51,850	52,056	64,782	68,799	85,396	91,198
Coarse	4,861	5,236	6,949	8,067	5,754	3,778	2,090	2,387	2,453	3,238	6,768	6,048
Medium	37,210	42,184	59,089	54,532	42,367	34,851	34,375	31,914	39,141	41,009	45,936	48,998
Fine	18,436	20,998	31,605	19,802	16,500	11,906	12,385	13,720	18,597	20,737	27,555	30,267
Superfine	6,917	6,746	9,140	6,974	3,879	4,146	2,454	1,977	2,317	1,548	2,510	2,868
Fents	1,120	1,749	2,301	1,805	1,525	1,653	1,544	2,056	2,223	2,265	2,626	2,417

STATEMENT No. VI.

Stocks of Cloth as on the last day of each month (in full bales).

	1953											
	Jan.	Feb.	Mar.	Apl.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
(a) Total physical stocks	121,575	99,465	111,449	108,716	97,911	107,527	127,607	112,140	155,632	161,699	148,855	158,026
(b) Quantity earmarked for export.	18,017	18,033	17,888	20,301	19,931	21,159	25,433	27,367	23,922	22,434	22,010	26,414
(c) Quantity earmarked for defence.	1,142	1,178	1,274	795	1,031	1,126	1,029	844	1,152	1,041	574	588
(d) Balance for civil consumption.	105,416	80,253	91,986	87,520	76,941	85,242	101,145	114,228	130,558	138,224	126,271	131,021
(e) Quantity paid for but delivery not taken.	20,756	13,815	14,320	17,987	18,354	18,674	19,898	22,781	20,523	21,023	29,842	30,017
(f) Balance awaiting disposal, as under.	84,660	66,438	77,666	69,533	58,587	66,567	81,247	91,446	110,035	117,200	96,428	101,006
Coarse	7,632	7,736	7,631	7,130	6,428	5,679	6,867	7,688	8,594	6,394	4,033	5,170
Medium	46,302	39,454	46,276	36,390	32,893	39,579	48,950	53,957	64,956	69,724	60,272	63,581
Fine	26,043	16,450	19,600	20,297	14,925	15,252	17,357	19,157	23,780	26,071	20,652	21,021
Superfine	2,247	1,037	2,233	3,990	2,860	4,260	6,376	8,737	10,734	12,742	9,663	9,047
Fents	2,435	1,759	1,922	1,724	1,479	1,796	1,696	1,607	1,970	2,268	1,806	2,185

STATEMENT No. VII.

Statement showing break-up of Exports of Cotton Piecegoods from the Indian Union, into Coarse, Medium, Fine and Superfine Cotton Piecegoods.

(INDIAN UNION)

((Source : Trade Controller, Bombay.)

	(In thousands of yards)		
	1951	1952	1953
Coarse	Not available	168.12	260.7
Medium	"	138.69	273.9
Fine	"	264.48	152.5
Superfine	"	22.57	14.2
TOTAL		593.86	701.3

Note.—The above figures represent quantities of cotton piecegoods "passed out for shipment" by the Export Trade Controller, and do not—repeat not—represent quantities actually shipped in the period. There is a lag between "passing for shipment" and "actual shipment" and the latter quantity is always less than the former. For instance, in the two relevant periods referred to above, total actual shipments from the Indian Union were :—

548 million yards in 1952 and
652 million yards in 1953.

NOTES.—(1) No break up figures for the year 1951 are available.

(2) Break up figures for the Port of Bombay alone are not available.

(3) Exports of handloom cloth which average about five million yards per month have not been included in the above figures.

STATEMENT No. VIII.

THE GAZETTE OF INDIA EXTRAORDINARY.

Part II—Section 1.

Published by Authority.

New Delhi, Thursday, December 17, 1953.

MINISTRY OF LAW.

The following Acts of Parliament received the assent of the President on the 16th December 1953 and are

hereby published for general information :—

THE DHOTIES (ADDITIONAL EXCISE DUTY) ACT, 1953.

No. 39 of 1953.

16th December 1953.

An Act to provide for the levy and collection of an additional excise duty on dhoties issued out of mills in excess of the quota fixed for the purpose.

Be it enacted by Parliament as follows :—

1. **Short title, extent and commencement.**—(1) This Act may be called the Dhoties (Additional Excise Duty) Act, 1953.

(2) It extends to the whole of India except the State of Jammu and Kashmir.

(3) It shall be deemed to have come into force on the 26th day of October 1953.

2. **Definitions.**—In this Act,—

(a) 'dhoti' means any type of grey or bleached cloth of plain weave which—

(i) is manufactured by a mill either wholly from cotton or partly from the cotton and partly from any other material ;

(ii) contains coloured yarn on its borders ;

(iii) has a width ranging between twenty-eight inches and fifty-four inches ; and

(iv) is commonly known by that name ;

(b) 'mill' means any building or place in which cotton yarn is spun and dhoties are manufactured by machinery moved otherwise than by manual labour, and includes every part of such building or place ;

(c) 'permissible quota' means the quota referred to in section 3 ;

(d) 'quarter' means the period of three months ending on the last day of March, June, September and December.

3. **Permissible quota.**—(1) The permissible quota of dhoties which may be issued out of any mill during any quarter, whether the dhoties were manufactured during that quarter or at any time previous thereto, shall be one-fourth of sixty per cent. of the total quantity of dhoties packed by that mill during the relevant period.

Explanation I.—For the purposes of sub-section (1), the Central Government shall, by notification in the Official Gazette, fix for all mills any period of twelve months which has expired before the commencement of this Act as the relevant period, and where any such period has been so fixed, the total quantity of dhoties packed by any mill during that period shall be determined with reference to the returns furnished in that behalf by the mill to the Textile Commissioner to the Government of India under the Cotton Textile (Control) Order, 1948 :

Provided that where, in the case of any mill, the relevant period so fixed is not applicable by reason of the fact that the mill came into existence or commenced working only during or after the expiry of the relevant period, the Central Government may, by a like notification, fix the permissible quota in respect thereof to be such quantity as, in its opinion is reasonable, having regard to the machinery and other equipment installed therein and to the other circumstances of the case.

Explanation II.—The permissible quota for the quarter of the year 1953 remaining unexpired at the commencement of this Act shall bear the same proportion to one-fourth of the said sixty per cent. or, as the case may be, to the permissible quota fixed under the proviso to Explanation I as the total number of days remaining unexpired bears to the total number of days in the quarter.

(2) Notwithstanding anything contained in sub-section (1), if, in the case of any mill or class of mills, the Central Government is of opinion that due to economic reasons connected with the nature of the machinery or other equipment installed therein a higher percentage than that specified in sub-section (1) should be fixed in respect thereof, it may, by notification in the Official Gazette, fix the permissible quota for a quarter for the mill or class of mills as one-fourth of such higher percentage as it may think fit, and where any such notification has been issued, the quota so fixed shall be deemed to be the permissible quota for the mill or class of mills within the meaning of this Act.

4. Levy of additional duty of excise on dhoties.—(1) Where the quantity of dhoties issued out of any mill on or after the 26th day of October 1953, exceeds in any quarter the permissible quota for that quarter, there shall be levied and collected on that quantity of dhoties so issued which is in excess of the permissible quota a duty of excise at the rate or rates which may be applicable thereto as specified in the Schedule.

(2) The duty of excise referred to in sub-section (1) shall be in addition to the duty of excise chargeable on cloth under the Central Excises and Salt Act, 1944 (I of 1944), and the Khadi and other Handloom Industries Development (Additional Excise Duty on Cloth) Act,

1953 (12 of 1953), and shall be levied and collected in the same manner as the duty of excise on cloth is levied and collected under the Central Excises and Salt Act, 1944, and the provisions of that Act and the rules thereunder, as far as may be applicable in this behalf, shall apply accordingly.

5. Power to make rules.—The Central Government may, by notification in the Official Gazette, make rule for carrying out the purposes of this Act, including, in particular, the submission of returns or other information relating to the manufacture or issue of dhoties by mills to such authority as may be specified in this behalf.

6. Repeal of Ordinance 6 of 1953.—The Dhoties (Additional Excise Duty) Ordinance, 1953 (6 of 1953) is hereby repealed.

THE SCHEDULE.

(See Section 4.)

Where the quantity of dhoties issued out of any mill during any quarter is in excess of the permissible quota for that quarter :—

	Rate of duty.
(1) in respect of the quantity which does not exceed the permissible quota by more than 12½% thereof	Two annas per yard
(2) in respect of the quantity which exceeds the permissible quota by more than 12½% thereof but does not exceed it by more than 25%	Three annas per yard
(3) in respect of the quantity which exceeds the permissible quota by more than 25% thereof but does not exceed it by more than 50%	Four annas per yard
(4) in respect of the quantity which exceeds the permissible quota by more than 50% thereof	Eight annas per yard

STATEMENT No. IX.

Average Prices of various items of Mill Stores during 1952 and 1953.

Description	Unit	Rate in		
		January to March 1952	January to March 1953	October to December 1953
		Rs. A. P.	Rs. A. P.	Rs. A. P.
Belting—				
1"	Foot	0 11 6	0 10 9	0 11 0
2"	"	1 15 8	2 0 6	2 3 6
1½"	"	1 5 7	1 5 6	1 8 7
3"	"	3 6 0	3 7 3	3 6 3
3½"	"	3 10 5	4 9 3	4 10 0
3¾"	"	4 15 3	5 13 6	6 5 6
Slubbing Bobbins	Gr.	152 9 8	151 9 4	147 15 7
Roving Tubes	"	111 9 5	111 9 4	109 13 9
Weft Pirns	"	46 11 3	42 10 6	42 10 6
2¼" Ring Doubling Bobbins	"	197 12 4	209 10 3	209 10 3
Picking Bands	Lbs.	6 5 8	7 3 11	7 6 7
Pickers	Gr.	210 5 0	228 8 3	208 3 3
Water Proof Papers	Roll	39 7 3	28 11 0	28 11 0
White Papers 80 lbs./Craft Papers 92¼ lbs.	Per ream	53 10 8	108 11 0	125 7 3
White Papers 50 lbs./Craft Papers 57½ lbs.	"	32 8 4	..	80 4 4
Bleaching Powder	Cwt.	55 13 6	32 6 0	58 14 6
Healds	Bdle.	176 1 5	208 12 11	243 4 11
Shuttles	Doz.	72 4 3	72 13 9	72 14 10
Reeds	Bdle.	112 0 9	121 10 3	123 14 9
Tallow	Cwt.	126 1 8	126 1 8	117 4 3
Soda—				
Caustic	"	55 7 3	59 7 0	59 7 0
Ash	"	27 11 1	25 3 11	27 3 7
Hydro Sulphite	Lbs.	1 8 0	1 8 0	1 2 4
Oil—				
Era	"	0 5 4	0 5 4	0 5 3
Spindle	"	0 7 0	0 7 11	0 8 2
Premier	"	0 5 6	0 5 8	0 5 7
Ellam	"	0 9 11	0 10 7	0 10 7
Cloth Hessian—				
8 oz.	Yd.	0 12 4	0 12 3	0 8 2
11 oz.	"	1 3 10	0 11 6	0 8 6

STATEMENT No. X.

FOREIGN COTTON.

Prices Free Bombay Dock Delivery.

		(In Rs. Per candy of 784 lbs.)									
		1951		1952		1953		1954		1955	
		end of March.	May.	July.	Oct.	Jan.	March.	June.	Aug.	Decr.	Decr.
KARNAK C. T. 154	.	.	4710 (R)	4300 (CC)	4191	4935	3864	3145	3212	2116 (52-53C)	2116 (1½) (52-53C)
KARNAK C. T. 163	.	.	4193 (R)	3775 (CC)	3788	3365 (NC)	2813	1979	2153	1898 (52-53C)	1898 (1½) (52-53C)
SUDAN G. 4S	.	.	4480 (R)	4335 (CC)	3600 (N)	4954 (4) (NC)	3542 (1) (NC)	2680 (1) (NC)	2560 (NC)	1813 (4 to 5) (52-53C)	..
XG3L.	.	.	4200 (R)	3975 (CC)	3350 (N)	4588 (4) (NC)	3182 (NC)	2500 (N) (NC)	2400 (N) (NC)	..	..
ASHMOUNI T. 3	.	.	3400 (R)	3100 (CC)	2837	2733	2351	1843	1910	1736 (52-53C)	1578
E. AFRICAN B. P. 52 Controlled	.	.	2200 (R)	2205 (CC)	2210 (CC)	2210 (CC)	2210 (CC)	2405 (51-52C)	2405 (51-52C)	1732 (3 to 4) (52-53C)	..
E. AFRICAN B. P. 52 Free	.	.	3900 (R)	2600 (CC)	2200 (N)	2670	2540	1710 (N) (51-52C)	1760	1565 (2 to 3) (52-53C)	1565 (2 to 3) (53-54C)
CALIFORNIAN S. M. 1-1/8"	.	.	2200 (R)	2400 (CC)	1800 (2 to 3)	1996 (1 to 2)	2002 (1)	1792 (4 to 6) (52-53C)	1877 (2 to 4) (52-53C)	1617 (52-53C)	1637 (1) (53-54C)
PAKISTAN N. T. Regd.	.	.	3150 (R)	2750 (CC)	2100 (51-52C)	2370 (51-52C)	2010 (51-52C)	1940 (51-52C)	1940 (51-52C)	1325 (52-53C)	1325

NOTE :—The figures in brackets immediately after or below the quotation indicate the period (i.e. the number of months) which elapses between the date of quotation and the date of shipment.

R=Ready.

OC=Old crop.

CC=Current crop.

NC=New crop.

N=Nominal.

51-52C=1951-1952 crop.

52-53C=1952-1953 crop.

53-54C=1953-1954 crop.

(Source : Volkart Brothers' Monthly Bulletin.)

STATEMENT NO. XI.

Effect of Government's order restricting the production of dhoties manufactured in Indian mills.

Dr. Matthai contended that the restriction on the production of dhoties had had the effect of keeping prices of dhoties high and that in fact mills had benefited from the restriction. Mr. Burns did not agree with this contention, and in turn pointed out that mills had had to replace dhoties in the looms with other sorts and that

this had resulted in over-production of such other sorts and consequent reduction in their selling prices.

In support of his statement, Mr. Burns has supplied the following statement which shows the selling rates of dhoties, mulls and voiles in each quarter from January 1953 to January 1954. In the case of superfine mills at any rate, dhoties have been replaced almost entirely by mulls and voiles, and Mr. Burns contends that the prices shown in this statement quite clearly confirmed the point made by him.

Ref. No.	Dimensions		Trade Name	Sale rate	Per	Month	Percentage increase or decrease as compared with Jan. '53.
	Ins.	Yds.					
Rs. A. P.							
Superfine Bld. Dhoty							
						1953—	
1000/D.B.	50	8	Karmaveer . . .	8 0 6	Pair	January	
1000/D.B.	50	8	Karmaveer . . .	8 11 0	„	April	+8%
1000/D.B.	50	8	Karmaveer . . .	8 11 0	„	July	
1000/D.B.	50	8	Karmaveer . . .	8 11 0	„	October	
						1954—	
1000/D.B.	50	8	Karmaveer . . .	8 7 0	„	January	+5%
Superfine Bld. Mulls							
						1953—	
3505/B	48	20	222	0 15 1	Yard	January	
3505/B	48	20	222	0 15 1	„	April	
3505/B	48	20	222	0 15 1	„	July	
3505/B	48	20	222	0 12 0	„	October	—20%
						1954—	
3505/B	48	20	222	0 12 0	„	January	—20%
Superfine Bld. and Mer. Plain Voile							
						1953—	
3013P/M	44	30	Adarshkala . . .	0 14 9	„	January	
3013P/M	44	30	Adarshkala . . .	0 14 11	„	April	+1%
3013P/M	44	30	Adarshkala . . .	..	„	July	
3013P/M	44	30	Adarshkala . . .	..	„	October	
						1954—	
3013P/M	44	30	Adarshkala . . .	0 11 3	„	January	—23%

At the request of the Association, Mr. Pratap Bhogilal has supplied the following information relating to the effect of the restriction on the selling prices of dhoties and mulls manufactured by his Mills at various times between January 1952 and 1954 :—

Dhoty 49" × 9 yds. (Superfine)

Mulls 47" × 20 yds.

Ceiling Price

Ceiling Price

Re.	Period	Re.
0 15 9	July, 1952	0 14 3
Sale Price	Period	Sale Price
Re.		Re.
0 15 9	November, 1952	0 15 7
1 0 5	January-February, 1953	0 15 7
1 2 4	May, 1953	1 0 7
1 4 8	May, 1953	1 0 7
1 4 0	August-September, 1953	0 13 9
1 0 3	November, 1953	0 12 3
1 1 5	January-February, 1954	0 13 9
1 0 11	February-March, 1954	0 13 6

It will be seen from the above statement that in the quarter ended July 1952, the ceiling prices of dhoties and mulls which were then controlled, were Re. 0-15-9 and Re. 0-14-3 respectively. Mr. Bhogilal observes :—

“You will please also see from the rates given above that the rates of dhoties have touched the maximum of Re. 1-4-8 per yard in the month of May 1953 and the minimum of Re. 1-0-3 per yard in the month of November 1953. The maximum rise in the rate of dhoty per yard has been,—

the difference between . . . $\left\{ \begin{array}{l} 1 \ 4 \ 8 \text{ and} \\ 0 \ 15 \ 9 \text{ i.e.} \end{array} \right.$ 0 4 11

and the minimum rise has been,—

the difference between —

the rate for November 1953 . . . 1 0 3 and

the minimum price of dhoty ruling in the month of November 1952 . . . 0 15 9 i.e. 0 0 6

As compared to that, the maximum rise in the rate of Mulls and Voiles had gone up to Re. 1-0-7 per yard for the month of May 1953, and there has been a consistent fall in their rates from August

STATEMENT NO. XIII.

Consumption of Foreign Cotton in Mills in Bombay City.

(Cotton year—September to August.)
(In bales of 392 lbs. net.)

Description		1950-51	1951-52	1952-53
Pakistan Cotton—				
13.	4F	1,276	424	99
14.	L. S. S.	305	883	70
15.	289-F	2,300	549	313
16.	N. T. (Sind)	1,748	540	247
TOTAL—Pakistan Cotton . . .		5,629	2,396	729
17. Egyptian Cotton—				
(a)	Ashmouni	931	19	3,041
(b)	Zagoras	349	..	58
(c)	Giza 30	6,916	3,578	3,562
(d)	Giza 23	728	..	..
(e)	Karnak	56,096	27,258	35,445
(f)	Menoufi	4,991	2,991	3,410
(g)	Other Egyptians	2,032	502	1,452
TOTAL—Egyptian Cotton . . .		72,043	34,351	47,808
18.	Sudan Egyptians	26,925	30,635	38,795
19.	Sudan Americans . . . . .	..	..	178
20.	East Africans	80,542	62,252	79,680
21.	Afghans	1,007	99	12
22. Americans—				
(a)	U. S. A.	195,944	245,028	136,510
(b)	Peruvians	8,009	5,720	1,873
23.	Brazilians	391	..	..
24.	Belgian Congo	160	307	642
25.	Other foreign cotton	118	38	2
TOTAL Foreign Cotton <i>excluding</i> Pakistan and Egyptian Cotton . . .		313,096	344,079	257,692
TOTAL—ALL FOREIGN COTTON . . .		390,768	380,826	306,229

(Source : Textile Commissioner.)

3/II/A/M/14(7).
Copy of letter dated 8th March, 1954 from the Mill-owners' Association to the Secretary, Taxation Enquiry Commission.

"When the Association's representatives appeared before the Enquiry Commission, Dr. Matthai and Dr. Rao raised certain issues connected with depreciation and rehabilitation, and it was understood that the Association's representatives would consider these issues and submit a written note thereon at a later date.

Briefly stated, Dr. Matthai put forward very tentatively a scheme which embraces (a) a general scaling down of rates of depreciation *plus* (b) an extension of tax relief on undistributed profits *plus* (c) loans if necessary from Industrial Finance Corporation or similar bodies at low rates of interest, if (a) and (b) were not sufficient to secure full rehabilitation.

It was also suggested that the facility mentioned in (b) would be available only to industries of national importance or those which afforded substantial employment. Dr. Matthai, according to our understanding, proposed that whatever tax relief is given under (b) would have to be deposited in a public institution like the Reserve Bank of India, withdrawals being permitted only on proof of purchase of machinery for rehabilitation. The transcript of the evidence (please see page 14) reports Dr. Matthai having said "when replacement has actually been made by withdrawal of that reserve,

you (meaning the industry) get a further rebate". We have not been able to follow this remark, and we are not quite sure whether Dr. Matthai contemplated a further rebate or allowance from Government over and above (a), (b) and (c) previously referred to.

Dr. Rao who followed Dr. Matthai, put two propositions before us, namely, (1) whether we would have any objection to the tax relief mentioned by us in item (b) being given and withdrawals therefrom being permitted under the supervision and control of a quasi-judicial body, and (2) whether we would have any objection to the benefit of tax relief in (b) being afforded only to particular units of the industry. The point here is that while Dr. Matthai appeared to be in favour of some sort of discrimination between industry and industry according to their importance from a national point of view, Dr. Rao appeared to go further and seemed to be in favour of relief being afforded on the basis of performance of individual units of the industry. For instance, even though the cotton textile industry may be regarded as a national industry, the relief to any individual mill would depend on the actual performance of that mill.

If we have understood the whole position correctly, then our submissions are as under :—

We are in agreement with the principle underlying the extension of tax relief on undistributed profits as

1953 onwards. The minimum fall in the rates of Muls is,—	₹	well as :	Re.	Re.
the difference of the rates—	Re.		Re.	the difference between—
in the month of November 1952.	0 15 7 and			the ruling rate for November 1952.
in the months of August-September 1953	0 13 9 i.e. 0 1 10			the ruling rates for February-March 1954
				0 13 6 i.e. 0 2 1

The maximum fall in the rate of Muls is,—

the difference between—	
the ruling rate for November 1952.	0 15 7 and
the rate ruling for November 1953.	0 12 3 i.e. 0 3 4

Thus, the maximum and minimum rise in the price of dhoty, being Re. 0-4-11 and Re. 0-0-6 respectively, when compared with the maximum and minimum fall in the rates of muls, being Re. 0-3-4 as well as Re. 0-2-1 and Re. 0-1-10 respectively, clearly indicates that the increase in the rates of dhoties has been more than offset by the fall in the rates of Muls and Voiles. This has been the result of the switch-over of the looms from the production of dhoties to the production of Muls and Voiles, on account of the Dhoty Control Order and as a consequence of which, there has been over-production and consequent over-supply to the market of Muls and Voiles."

STATEMENT NO. XII.
Consumption of Indian Cotton in Mills in Bombay City.

(Cotton year—September to August.)
(In bales of 392 lbs. net.)

Description	1950-51	1951-52	1952-53
1. Bengal Deshi	20,874	13,415	10,231
2. Oomras Short staple—			
(a) Oomra Deshi	1,100	6,948	4,696
(b) C. P., I and II	4,426	284	3,578
(c) C. I. Deshi	4,256	517	1,367
3. Oomras Long Staple—			
(a) Jarilla	174,242	293,920	492,427
(b) Gaorani 6 and 12	22,009	38,226	49,941
(c) Parbhani Ann.	878	1,127	2,387
(d) Gburi	7,582	13,484	20,275
4. East Punjab American—			
(a) 216-F	8,304	8,099	13,528
(b) L. S. S.	1,816	550	10,103
(c) Other American . . . . .	..	..	4,888
5. Broach Vijay.	98,307	79,888	98,251
6. Surti	39,583	36,052	62,628
7. Dholeras—			
(a) Wagad	55,842	48,809	30,762
(b) Kalyani	14,855	11,963	9,418
(c) Mathia	6,836	4,181	4,268
8. Northern/Western—			
(a) Mungeri	4,581	3,697	807
(b) Farm	27,689	25,307	10,634
9. Coconadas/Warrangal	447	..	..
10. Comptahs—			
(a) Jayadhar	24,865	41,778	57,003
(b) Laxmi.	3,215	13,240	28,074
(c) Upland . . . . .	..	..	1,133
11. (a) Cambodia	2,201	6,266	1,883
(b) Karungami	1,760	453	195
(c) Rajapalayam . . . . .	..	..	10,574
12. Other Indian Cotton	6,283	4,152	136
TOTAL—Indian Cotton	531,951	652,365	929,187

(Source : Textile Commissioner.)

this is a direct incentive to set aside sums for rehabilitation, but we do not agree that such a proposal should differentiate between one industry and another or between one unit and another of the same industry. We submit that the practical operation of the relief, regardless of whether it is vested in Government or a quasi-judicial body, which would be the sole authority to decide whether an industry or a unit should be allowed facilities to rehabilitate and in effect almost whether an industry should be allowed to continue or not, would be difficult and lead to discrimination which in our opinion is wrong in principle in a democratic state. The proposal which seeks to link relief with undistributed profits should be available to all industrial assesses and not only to selected industries or units of an industry.

3/II/A/M/14(8).

Copy of letter dated 16th March 1954 from the Secretary, Millowners' Association to the Secretary, Taxation Enquiry Commission.

"I am directed to refer to the discussions which took place when the representatives of the Association tendered oral evidence before the Commission on 8th February 1954. Our representatives were asked to consider certain propositions made by the Chairman and Dr. Rao. Briefly stated, (quoting from the official records), the proposition referred to reads as under:—

"Dr. Rao: The suggestion I want to put to you is this. You may consider it a mad suggestion. Following up what you said, in principle we must not regard the handloom industry and the organised textile industry as having any conflict of interest. We should regard them as complementary. If you want to regard them as complementary, and therefore not try to bring about any kind of discrimination between them in terms of regulation of production and reservation of markets, would you think that there are enormous difficulties to a scheme that might pool together the products of handloom industry and organised textile industry, the sale of course being according to the price for which the cloth should be disposed of? You might pool them together on the analogy of steel during war time. During the war they had a system by which high prices were paid for imported steel, a little lower prices for Mysore steel and the least prices for Tata steel. There might be difficulties in the suggestion which I am making with regard to cloth. Firstly, would you, in principle, object to a scheme which might bring together the products of the handloom industry and the textile industry for purposes of marketing, with some kind of pool price arrangement? Secondly, do you think such a thing can be considered in principle, even if you object to it? The kind of solution that is now being attempted is disastrous. We have to find a solution. If, therefore, a solution of the kind suggested is worthy of consideration, if not of acceptance, what would be the technical problems involved?

THE STOCK EXCHANGE, BOMBAY.

Mr. Chairman: Is this pooling without any idea of output on either side? Under a pooling arrangement, it would work on the basis of competitive conditions.

Dr. Rao: Yes. I am anxious to see that nothing should be done to prevent the expansion of the organised textile industry. If I had my way, I would like to remove the restriction on the installation of new looms. I would like to pool the products of the two together. The handloom industry will continue to exist, the organised textile industry will also continue to exist. The consumer will get a pooled price, which will not give him all the benefit he would get from the organised textile industry.

"Mr. Chairman: It would mean that the handloom industry and the mill industry work side by side under normal competitive conditions, and then under the pooling arrangement that you have in mind there would be a retention price by the handlooms and by the mill according to their cost, and there would be a selling price which would be a uniform price which would be paid by the consumer, and the difference between the retention price and the selling price will provide a kind of equalisation fund."

2. Our representatives promised to consider the above proposition and send in a written memorandum, which I am now asked to submit herewith.

3. A combined pool of the goods manufactured by the Indian cotton mill industry and the Indian handloom industry could only hope to succeed if the total quantity of cloth available in India fell short of the actual requirements of the population of the country. That, by no means, is the position today when we have to export at least a thousand million yards of cloth at competitive

prices to avoid a glut in the domestic market. A pool of the nature referred to pre-supposes the establishment of a body with adequate finance to take over and sell the products of the mills and the handlooms. The Commission did not disclose their ideas in this regard, but whatever the organisation which they have in view, my Committee submit that that organisation would ultimately find themselves in the position of having to be the salesmen of goods manufactured by mills and the handlooms whatever they are. This is not likely to be an enviable position, as we know from the bitter experience everybody concerned had with the manufacture and sale of standard cloth in the country in the early days of the war.

4. In a surplus market, quality is the deciding criterion in the matter of sales, and the incentive to improve quality would be killed if the distribution of the cloth were to be vested in other people's hands.

5. Coming now to practical considerations, our representatives venture to ask whether it will be a simple matter to fix basic prices for the varieties of cloth manufactured in India by the mills and the handlooms, and to provide for their marketing in India and abroad. In the case of the Iron and Steel trade which the Commission referred to, perhaps the pool had only to deal with a very small number of items, but the position is quite different in the Textile Industry where each mill produces a very wide range of goods. Apart altogether from the desirability of such a scheme, which my Committee doubts, my Committee hold the view that it would be quite impracticable of application.

6. For all these reasons, my Committee are not in favour of the proposition referred to."

Replies to the questionnaire of the Taxation Enquiry Commission.

NOTATION.—The numeral before the period refers to the number of the Question in the Questionnaire and the numeral after the period indicates the number of the paragraph of the reply to that Question.

NOTE.—The statistical data appearing in the Reply is intended to illustrate the order of magnitude or the direction of the trend.

PART I—THE TAX SYSTEM.

Question 1.—What, in your opinion, should be the objectives of a sound tax policy? What should be the place in such a policy of the following objectives: (a) reduction in inequalities of income and wealth; (b) encouragement of incentives to work, to save and to invest; (c) countering of inflationary and deflationary tendencies; and (d) maintenance of the external balance of the economy?

In what directions would you suggest modification of the Indian tax system having regard to these objectives?

1. 1. The Problem.—The study of Indian taxation is a study in poverty and population—stark poverty on the one hand and a vast population on the other. China excepted, no other country in the world shows such extremes; as witness the following—

TABLE NO. 1. I.
(Year: 1948)

Country	Population Mn.	National Income 1,000 Mn. Rs.	Per Capita Income Rs.
U.S.A.	147	738	5,044
Sweden	7	24	3,528
Canada	13	42	3,157
Switzerland	5	14	2,933
U.K.	50	137	2,744
Australia	8	21	2,682
Denmark	4	11	2,602
New Zealand	2	5	2,440
Norway	3	8	2,355
Belgium	9	18	2,152
Netherlands	10	16	1,640
France	41	58	1,412
Germany	47	63	1,331
Czechoslovakia	13	14	1,131
U.S.S.R. (1946)	193	197	1,020
South Africa	12	11	930
Yugoslavia	16	13	792
Italy	46	34	748
Turkey	20	9	460
Japan (1949)	81	27	326
India	342	87	255
Burma	18	3	169
China	464	41	89

(Base on Tables Nos. 1, 54 and 55, U. N. Monthly Bulletin of Statistics, Sept. 1953, and U. N. Statistical Papers, Series E No. 2).

Herein lies the crux of the problem of taxation—the heart of its conflicts, the centre of its complexities and contradictions.

1. 2. *The Principle of Maximum Social Advantage.*—The tax system should be designed on what has been called the principle of maximum social advantage. Taxes represent transfer of purchasing power from private hands into the hands of public authorities and public expenditure brings it back to individuals. In the process, the amount of wealth and its nature undergo a change and its distribution among individuals and classes is altered. Social advantage is maximised when the quantum of the national income increases or its character and quality improve and when the dispersion around the *per capita* income is the smallest so as to make the average more truly representative of various groups and less variable over periods of time. In plain words, that tax policy is best which increases the size of the national cake and ensures a more even distribution. Unfortunately, these two objectives do not always co-exist or necessarily work in the same direction. "Within a limited period, there is always a measure of conflict between one objective and another and, in the formulation of a plan for a given period, it is necessary to proceed in terms of priorities as between these objectives themselves, laying more stress on some and less on others."* The question of priority therefore arises.

1. 3. *Fundamental Objectives.*—The elimination of poverty in an under-developed country like India cannot obviously be achieved by redistributing existing wealth. Economic development in such circumstances cannot proceed far unless the community learns how to get from its resources of men and materials a larger output of commodities and services. This fundamental objective is set out by the Government of India in its Resolution on Industrial Policy enunciated in April 1948. The Resolution says :

"A dynamic national policy must, therefore, be directed to a continuous increase in production by all possible means, side by side with measures to secure its equitable distribution. In the present state of the nation's economy, when the mass of the people are below the subsistence level, the emphasis should be on the expansion of production, both agricultural and industrial"†

Quoting the Resolution, the Fiscal Commission (1949-50) stresses its basic character in the following terms :

"We have set out the articles of the Constitution and the pronouncements in the Government of India's resolution relating to economic objectives as they embody decisions reached after lengthy discussions in Parliament and outside and are 'fundamental in the governance' of the country and all policies should be shaped with full advertence to them"‡

The Planning Commission carries the issue to its final conclusion as under :

"While it would be wrong in this sphere to think in static terms and to condone the existence or accentuation of sectional privileges, it is no less important to ensure a continuity of development without which, in fact, whatever measures, fiscal or other, might be adopted for promoting economic equality might only end up in dislocating production and even jeopardizing the prospects of ordered growth".**

A substantial and rapid increase in the productive equipment of the community, therefore, takes precedence over other objectives.

1. 4. *Priority No. 1.—Encouragement of Incentives to Work, to Save and to Invest.*—Taxation is a social instrument which makes collective life possible. Co-operative expenditure is essential for maintaining the social fabric, as in the performance of the most elementary duties of the State. Co-operative expenditure is also incurred for enlarging and improving the social fabric, as when the State adds to the productive equipment and ability of the community. A tax is a compulsory contribution and subtraction from wealth in private hands. If the State were to man and run the productive organisation, like Hobbes's Leviathan, the confiscation of the entire savings through taxation would not harm general welfare. But when it does not, taxation must not trench upon savings if private enterprise is to play its part and function effectively. The importance of private enterprise has been recognised by the Government of India in its Resolution on Industrial

Policy* and its broad sweep is clearly indicated by the Planning Commission which lays down that—

"The scope and need for development are so great it is best for the public sector to develop those industries in which private enterprise is unable or unwilling to put up the resources required and run the risks involved, leaving the rest of the field free for private enterprise".†

Obviously, private enterprise and effort cannot play a significant part in the process of development unless there is investment at the instance and initiative of the entrepreneur for replacement of old and worn out equipment and formation of new capital. It is therefore necessary to ensure, as the Planning Commission realises, "that the level of expenditure in the public sector and the devices used for finding the needed resources are not such as to react too adversely on the private sector, the development plans of which are of equal significance from the point of view of the community's interests".‡ In other words, the resources available to the public sector must be determined not merely in relation to the State expenditure but must be linked up with the needs and resources of the private sector. There is a single pool of investible resources on which the private and the public sectors have to draw and the Planning Commission acknowledges that—

"The problem is not merely to find resources for the public sector but to enlarge progressively the size of the common pool".§

It is impossible to impose heavy taxation in a modern community without thereby causing a check to production and diminishing the "common pool". The check is most certain and serious on the ability to work and save, particularly on the ability to save. As Dalton observes, "heavy taxes on the rich, though defensible on other grounds, reduce ability to save in a specially marked degree".¶ Expectations that such taxes will continue influence even more the desire to save and produce. The Planning Commission therefore sounds this note of caution :

"Direct taxation of the rich is likely to impinge more on their savings than on their consumption. There is need for balancing the advantages of a greater equality of income and wealth against the disadvantage of a possible fall in private savings and capital formation".||

It follows that, in the interests of production and capital formation, savings should not be laid under heavy tax. Encouragement of incentives to work, to save and to invest should be accorded the first and the highest priority.

1. 5. *Limited Scope for Reduction in Inequalities of Income and Wealth.*—It has been stated above** that more even distribution of the national income, that is, reduction in inequalities of income and wealth, is a factor maximizing social advantage. Improvement of the human material through social services like education, technical training and health brings in significant returns from the point of view of increasing production. It is conceivable that even when the size of the national cake is stationary or diminishing, social advantage might be maximised by reducing inequalities of *per capita* income. This would be the case, for example, when the quantum of the national product is very large and the number of people in whose favour the redistribution is being effected is relatively small.†† These conditions cannot be fulfilled in India.‡‡ Assuming that the entire income of the income-tax paying group is distributed *pro rata* amongst the entire population, the share of each individual would be infinitesimally small. As Table No. 1. II shows, the amount per head would be about Rs. 16 or Rs. 17 and there would be little gain in social satisfaction. On the other hand, as Table No. 1. II further shows, a handful of people constituting

* Government of India Resolution on Industrial Policy, 6th April, 1948, Para. 6.

† The First Five Year Plan, Ch. XXIX, para. 7. See also Ch. III, Para. 1.

‡ *Ibid.* Ch. II, Para. 32.

§ *Ibid.* Ch. III Para. 1.

¶ Dalton, Principles of Public Finance, Ch. X, Para. 2.

|| *Ibid.* Ch. II, Para. 33.

** See Para. 1 2 above.

†† "In the U. K., in the decade since 1938, a noticeable redistribution of incomes, both before and after taxation, in favour of wage-earners has taken place, largely due to changes in taxation and the extension of social services. According to the Chancellor of the Exchequer, the limit to this process appears to have been reached and it is felt that it would now be desirable to concentrate on increasing the national dividend". Reserve Bank of India Report on Currency and Finance, 1948-49, p. 46.

‡‡ See Para. 1. 1 above.

* The First Five Year Plan, Ch. II, para. 5.

† Government of India Resolution on Industrial Policy, 6th April, 1948, Para. 2.

‡ Fiscal Commission Report (1949-50), Ch. II, Para. 12.

** The First Five Year Plan, Ch. II, Para. 8.

TABLE NO. 1. II.

Year	Population	Total No. of assesses	Total income assessed to income-tax and super-tax	Total income -tax and super-tax paid	Total No. of assesses (Col. 3) as percentage of total population (Col. 2)	Pro rata share of Total Income Assessed to tax (Col. 4) per head of Population (Col. 2)
	Crores	Lakhs	Crores of Rs.	Cores of Rs.	per cent	Rs.
1948-49	34.2	4.72	585	144	0.14	17
1949-50	34.6	4.50	604	159	0.13	17
1950-51	35.8	4.72	575	155	0.13	16

(Source : C.B.R. All-India Income-tax Revenue Statistics.)

less than one-eighth of one per cent. of the total population contributing as much as 40 per cent. of the total Central tax revenue would be penalised in a vain pursuit of equality and the sequestration of their wealth and the dissipation of their accumulated resources would directly affect the productive effort of the community. As Walter Bagshot has remarked in another connection, "a million in the hands of a single banker is a great power....But the same sum scattered in tens and fifties through a whole nation has no power; no one knows where to find it or to whom to ask for it". Reduction of inequalities involving dispersal of resources would, *pro tanto*, reduce the effectiveness of such resources. The size of the national income would dwindle substantially and the prospects of future development would be seriously prejudiced. In the circumstances, reduction in inequalities of income cannot be made the principal objective of a tax policy. As Sir Josiah Stamp has observed, differences in wealth have same economic warrant behind them and it cannot be the primary object of taxation to destroy the inequalities of distribution, particularly in an under-developed economy. Therefore, all that can be said is that, consistent with the main requirement of encouraging incentives to work, to save and to invest, a tax system which tends to reduce within reasonable limits inequalities of income and wealth is to be preferred. At the present juncture, there appears to be little scope even for this limited objective. Historically, under-developed economies have levelled up inequalities of income and wealth by a fuller utilization of their manpower and latent resources. Any attempt to reverse the process in this country through an unwise use of the tax system will only end in equality of poverty.

1. 6. *Political Pressure and the Directive Principles of the Constitution.*—It is no more than stating the truth that frequently political and not economic considerations determine the choice of policy. The pressure exerted by politics on tax policy in the direction of reducing inequalities is apparent from Table No. 1. III (page 7) and its influence cannot be missed. What is right politics is not necessarily right economics. What is good from the point of view of capturing or retaining power is not necessarily or ultimately good from the point of view of the best interests of the country as a whole and in the long run. It is time these facts were recorded. Economic development must take precedence over ideological considerations and the answer is to be found in the Directive Principles of State Policy embodied in Part IV of the Constitution of India. Significantly enough, Articles 39 (c) of the Constitution disapproves of "concentration of wealth and means of production" only when it

operates "to the common detriment". Clause (b) of the same Article enjoins that pattern of distribution of ownership and control of material resources which is found "best to subserve the common good". Clause (a) insists that all citizens "have the right to an adequate means of livelihood". These Directives squarely place the objective of economic development and progress right in the forefront of all other objectives. They imply a large volume of savings and greater incentive to achieve a higher rate of growth. And unless one is inclined to contribute to the Hegelian "doctrine of general will" which makes the State a super-organism of indefinite and infinite power, the emphasis on tax policy must fall on encouragement of incentives to work, to save and to invest without which economic efficiency and the rate of growth cannot be maintained nor can the national product increase at a progressively faster pace.

1. 7. *Inter-relation between Inflation, Deflation and Balance of Payments.*—The problems of inflationary and deflationary tendencies and of the external balance of payments are closely inter-related. Inflation or deflation implies a change in the internal price level with corresponding adverse or favourable pressure on the balance of payments. Such movements in prices and external balance are the commonplace of modern economic experience. The question is to what extent can control of these movements be made a principal objective of a sound tax policy.

1. 8. *Limitations of the Tax System as a Stabilizer.*—An economy, if it is to work at maximum efficiency, should not labour under any marked inflationary or deflationary pressures. Tax collections on the part of the State reduce the purchasing power in the hands of the people and as such tend to have a deflationary effect. On the other side, public expenditure pumps purchasing power into the system and the effect is inflationary. Public income and expenditure thus directly affect the volume and direction of economic activity. It follows that the greater the proportion of public revenue and expenditure to the aggregate national income and expenditure, the greater is the influence and effectiveness of the tax system as an instrument for economic stabilization. The relative proportions of such expenditure in various countries are shown in Table No. 1. IV. In U. K.

TABLE NO. 1. IV.

Country	Govt. expenditure as Percentage of Aggregate National Expenditure
U.K.	40 Approx.
Australia	30 "
U.S.A.	25 "
Canada	25 "
India	8 "

(Source : The First Five Year Plan, Ch. II, Para. 31.)

the budget has been effectively used as an instrument for the control of inflation. For example, to secure the objective of disinflation and to finance rehabilitation, the accent on budgetary policies in post-war years was on obtaining surplus revenues so as to meet not only the ordinary Government expenditure but also Government outlays on public account. It is doubtful whether, in the current circumstances in India the tax system can be used as a stabilizer for neutralizing inflationary and deflationary trends. The principal drawback lies in the fact that the *per capita* incomes are extremely small and are held by people who are ordinarily outside the field of direct or even indirect taxation. The smallness of

TABLE NO. 1. III.

Country	Population	Population Entitled to Vote	Population paying Direct Tax	Population paying Direct Tax as Percentage of that Entitled to Vote
	Mn.	Mn.	Mn.	per cent.
U.K.	50	35	22	63
U.S.A.	147	95	55	58
Australia	7.5	4.5	2.5	56
Canada	13	7	2.5	36
India	342	175	0.5	0.3

the coverage of income and profit taxes in the economy and the difficulties in the way of taxing small incomes and the enormous agricultural sector adequately, either through land revenue or otherwise, impose severe limitations on the effectiveness of the tax system. For example, during the war and post-war years, the agricultural sector remained largely untouched because of the insensitivity of land revenue to rising incomes and in spite of drastic and effective increases in the rates of direct taxes the tax system was unable to drain off surplus war incomes and thus control inflationary pressure through public finance. The attempt at more control and greater public savings secured by heavier taxation failed to yield results. It merely led to inflation and erosion of private savings. Ultimately, the way out was seen in less control and lighter taxes to facilitate private investment out of larger available savings. Accordingly, as pointed out in a recent U. N. public finance survey,—

"It seems unlikely that in a country like India public finance can ever be a very powerful stabilizing instrument".*

The comparative importance of the tax system in an integrated policy naturally varies with the circumstances of a country and the needs of the times. But in an under-developed economy like that of India, in which all the budgets of the public sector account for less than 10 per cent. of the national income, the tax system may influence but cannot successfully combat inflationary or deflationary situations (the remedy for which lies in dealing with the root causes directly); nor can any such objective be made or deemed to be the only or the most important end of a sound tax policy.

1. 9. *Limitations of the Tax System for Maintenance of External Balance.*—What holds true for the tax system in regard to the internal inflationary or deflationary situation also holds true for its external counterpart, the international balance of payments. The imposition or removal of import and export duties and increase and decrease in their rates would no doubt influence the volume of imports and exports and to that extent affect the maintenance of the balance of payment. But such regulation cannot correct a fundamental or deep-seated disequilibrium, particularly when as in India, the proportions of the external trade to the total trade and of Government expenditure to the total national expenditure are relatively small. In economies like those of the U. K. where external trade and Government expenditure form a substantial portion of the total trade and national income, the needs of the payments problem may be met by budgeting for a surplus on the revenue side of the account with a view to enforcing austerity on consumption.† But such disinflationary budgeting to counter inflationary pressures at home in an endeavour to correct the widening adverse balance of payments failed to achieve results in India during the postwar years.‡ It bred further inflation and discouraged the flow of foreign capital. Likewise, the attempt at a comprehensive fiscal programme framed with the dual object of increasing the supply of imported goods and simultaneously decreasing the volume of purchasing power also failed. The difficulty was in increasing the volume of goods sufficiently to halt inflation without putting an unsupportable strain on the balance of payments. Ultimately, the solution was seen in devaluation. The concurrent increase in import and export duties was more for the purpose of intercepting windfall gains in particular directions during the period of adjustment than for protecting the balance of payments as such. The reluctance since then to scale down and abolish these duties has been due to the excessive preoccupation with the budget—which, according to Per Jacobssen, is a peculiarly British tradition—and to that extent the balance of payments has been adversely affected. But the utility of the tax system as a stabilizer in this direction is severely limited. An appropriate exchange rate, because of its influence on prices and production, is vastly more important for keeping external equilibrium than any budgetary devices. The maintenance of the external balance of the economy, therefore, cannot be weak or deemed to be the only or the most important objective of a sound tax policy.

1. 10. *Conclusions.*—In conclusion it may be said that the pressure of persistent inflationary and deflationary situations and disequilibria in the external balance of payments generally indicate a fundamental lack of health in the economy. Though, for a time, appropriate tax measures might be the most effective and perhaps the only remedy available for counteracting the position, the ultimate remedy lies in correcting the basic weakness of the economic system so that it might

function in good order. A sound tax system is an essential but not the only ingredient of such a remedy. A sound internal economy and a satisfactory basis for external financial relations are equally important. The three must be welded together into a balanced financial policy. It appears that we have relied too much on the tax system and have been striving to achieve more things through it than are immediately possible. The system should be made and felt by all groups of people to be fair and equitable. Equity is not equality in the circumstances of an under-developed economy and this fact must be realised and accepted in order to create the conditions in which the best efforts can be put forth in all directions for promoting development. It is only through rapid development that inequalities of income and wealth can be reduced by raising the general standard of living. In the meanwhile, as Schumacher has advised in the case of backward countries, taxes should be levied more on consumption than on saving, there should be long-term borrowing for purposes of productive investment, and the budget should be kept as small as possible by controlling public expenditure which can be accomplished only through elimination of waste, extravagance, corruption and incompetence. The accents of policy must change accordingly and the Indian tax system should be suitably modified—

- (a) By enlarging the coverage of taxation without which, as the Planning Commission warns, "the tendency will be not only for tax revenues to fall as a proportion of further additions to national income but to make the sharing of the burden of development increasingly inequitable";
- (b) By diversifying taxes so as to produce a well-balanced tax structure;
- (c) By scaling down the degree of progression and the rates of direct taxes—whether income-tax, super-tax or death duties—imposed for reducing inequalities of income but which only succeed in reducing economic efficiency and social advantage;
- (d) By granting tax concessions in the form of larger depreciation and replacement allowances to existing industries and giving tax exemptions and rebates to new industries and to income from investment in new ventures;
- (e) By reviewing import duties and reducing or abolishing export duties imposed for intercepting windfall gains following on devaluation, without paying undue attention to what they would cost in terms of revenue, so that exports and production may be encouraged and foreign markets retained; and
- (f) By streamlining the tax system as a whole by reducing the tax burden and simplifying the tax structure, keeping in view the needs of an under-developed economy and the urgent necessity of promoting savings at home and attracting capital from abroad for purposes of investment and future development.

Question 2.—What criteria would you suggest for determining the equity of a tax system? How far is it possible to secure it in the Indian tax system?

2. 1. *The Criterion of Equity.*—In the complex conditions of today, when there are in existence Central, State and local taxes, it is difficult to formulate precise principles for determining the equity of a tax system. The entire tax burden cannot be adjusted to equity amidst what Lutz has described as "the welter of taxation imposed by different authorities, imposed on all manner of different bases and for purposes that are sometimes widely diverse and again overlapping". The problem is further complicated by the intricacy of the process by which taxes are shifted and the extreme difficulty of tracing their ultimate incidence. And lastly, so much depends upon the point of view that it is by no means easy to formulate a set of principles commanding general acceptance. Equity in taxation, therefore, seems difficult to define, and since no one principle can be definitely said to be right to the exclusion of all others, each must be applied on a pragmatic basis before reaching a final conclusion.

2. 2. *The "Cost of Service" and "Benefit of Service" Principles.*—One kind of equity would be to apply either the "cost of service" or the "benefit of service" principle. It would be equitable to conceive of a tax as payment to the State towards the cost incurred for services rendered to the tax-payers or for benefits received by the tax-payers. But it does not seem feasible to determine the cost of service in respect of each citizen, nor can the benefit derived from most forms of public expenditure be clearly ascertained. After all, a tax by

* U. N. Public Finance Surveys—India (1951), p. 12.

† See Reserve Bank of India Report on Currency and Finance, 1949-50, p. 16.

‡ See U. N. Public Finance Surveys—India (1950), p. 6.

* The First Five Year Plan, Ch. III, para. 17.

definition is a payment in return for which there is no direct and specific *quid pro quo*.*

2. 3. *Principle of "Ability to Pay".*—The third alternative principle is that of the individual's "ability to pay". Assuming that marginal utility of income diminishes as income increases, there would be equity in differential taxation. On this view, ability to pay may be interpreted to mean minimum or proportional or equimarginal sacrifice. The principle of minimum sacrifice would make the total direct real burden of tax on the community as small as possible. This would imply the taking away of all income above a limit on the assumption of diminishing marginal utility of income. Such a result would hardly square with notions of equity and fairness held by many. More important than that would be the overwhelming objection on grounds of economy, as it would probably check all work and saving beyond that required to secure the maximum income not subject to taxation. Social justice might also be taken to mean not equal incomes for all, but either proportional sacrifice so that the direct real burden on every taxpayer is proportionate to the economic welfare he derives from his income, or equimarginal sacrifice so that those with larger incomes pay quantitatively more than those with smaller incomes to the point where the sacrifice at the margin is equal. Both these principles would not cut unequal incomes to the same height but would lead to varying degrees of progression in the tax system, implying that the heaviest burdens should be placed on the broadest shoulders.

2. 4. *Equity—An Elusive Concept.*—Notions of equity apparently differ from individual to individual, from time to time and place to place. It almost seems that all principles of equity are largely matters of opinion. In the words of Dalton—

"Equity often seems to say 'No', but hardly ever 'Yes', an elusive mistress, whom perhaps it is only worth the while of philosophers to pursue ardently and of politicians to watch warily."†

The problem is even more difficult for the Indian tax system which rests on an extremely narrow basis. In an under-developed economy with an expanding population, the principles of benefit, cost, sacrifice and ability are in greater conflict than elsewhere. Because of the limited size of the national cake, either the public sector appear to take away too much or the private sector is left with too little. If the tax rates are increased progressively, they become unfair and oppressive to a relatively small group of people. They also hamstring economic development by reducing the ability to save and the incentive to invest and form new capital. In the other direction, the smallness of the incomes magnifies the tax burden disproportionately. Taxes soon turn regressive and though spread over the large majority of the people they are held to be equally unjust. Broadly speaking, there is little room for manoeuvring. It would be therefore more appropriate were the Indian tax system conceived with the object of maximum social advantage—not equity, primarily, but economy.

2. 5. *A Pragmatic Approach.*—In the long run, the principles of equity and maximum social advantage will be more fully reconciled as economic development progresses throwing up a larger *per capita* income. For the duration, equity can be best served by restricting demands on revenue to the minimum possible. This implies stringent control of wasteful, negative and unproductive expenditure. On this pragmatic approach, the Indian tax system should be modified on the following lines:

- Taxes should be broadly based over all economic groups.
- Taxes should be roughly fair as between the different elements of the community.
- Taxes should be widely spread and diversified so as to eliminate "free riders" and make revenue more easily and completely collectible.
- Taxes should not hit too heavily at one point. The higher a tax rate is "jacked up", the greater the incentive to tax avoidance. As is now generally recognised, "indiscriminate taxation ends in unnecessary resentment, occasionally in serious injury and sometimes in flagrant waste".
- Taxes should be so framed as not to impair the productive powers of the community, that is, they should not bear down on production and saving but only discourage consumption.
- The balance of the tax structure now topheavy with direct taxes should be restored by distributing the tax load through indirect taxes,

* See Tanzi, *Principles of Economics*, Vol. II, Ch. 66. Also see Report of the Indian Taxation Inquiry Committee (1924-25), Ch. II, Para. 11.

† Dalton, *Principles of Public Finance*, Ch. IX, Para. 6.

reaching incomes that escape direct tax and curbing spending rather than production and savings as at present. In the current state of development and income distribution, only taxes on consumption can obviate the imperfections of income and profit taxes and bring about a greater measure of distributive justice.

Question 3.—Does the Indian tax system conform adequately to the principle of ability to pay or do you think an extension of this principle is desirable and practicable? If so, in what ways?

3. 1. *Principle of "Ability to Pay".*—It was Adam Smith who laid down that—

"The subjects of every state ought to contribute towards the support of the Government as nearly as possible, according to their respective abilities, that is to say in proportion to the revenue which they respectively enjoy under the protection of the State".*

This principle arises from the desire to distribute the tax burden so as to bring about an equality of the pressure of taxation, an equality of sacrifice. On this view, it has to be understood in its broadest sense. It has been stated in answer to Question 2 above that, on reasonable assumptions, the principle of "ability to pay" is not necessarily limited to proportional taxation as specified by Adam Smith but implies some degree of progression in the tax structure. It is however easy to carry progression too far by mistaking equity for equality. Dalton has therefore emphasised that for bringing about an ideal distribution of the direct money burden of taxation—

"We must measure the relative ability of individuals to pay by the relative effects of their payments, not only upon distribution, but upon production and, indeed, upon the whole economic welfare of the community."†

Thus A's ability, compared with B's to pay a given tax depends upon the relative aggregate economic loss resulting from payment in the two cases. For this, account must be taken, not only of the direct loss of economic welfare to A and B individually, but also of any indirect loss or gain to others comprising the community as a whole. It would appear that in determining the ability to pay as indicated by income, property and consumption, this important consideration has been overlooked in the Indian tax system in recent years. Apparently, all the stress has been put on the mere magnitude of the income to the neglect of other aspects. The tax structure has therefore tended to distortion and turned lopsided.

3. 2. *Principle Misapplied in Practice.*—It is easy to illustrate the point that the principle of ability to pay has not been correctly interpreted in the context of an under-developed economy like that of India. During the war and post-war years, the volume of direct tax revenue, being under Government control, was steeply raised by increasing the rates and overlapping the taxes on the same base under different guises—income-tax, super-tax, corporation tax, surcharge, Excess Profits Tax and Business Profits Tax. For example, the highest bracket of personal incomes, which had borne tax at 59 per cent. in 1939-40, was subjected to a rate of 97 per cent. in 1946-47, while the highest rate of company tax, which was 22 per cent. in 1939-40, was raised to 48 per cent. in 1945-46. In addition, there was the E. P. T. at 60 per cent. as well as a system of compulsory E. P. T. deposits. The quick upsurge of drastic taxation of personal and corporate incomes can be seen at a glance from Table No. 3. I. In the same manner, taxes on in-

TABLE No. 3. I.

Income Rs.	Percentage of Income paid as Tax				
	1939-40	1944-45	1945-46	1947-48	1952-53
PERSONAL					
5,000 . . .	3.3	5.5	4.7	3.1	2.3
10,000 . . .	5.6	9.2	7.9	5.9	5.1
25,000 . . .	10.9	19.3	17.6	15.3	13.2
1,00,000 . . .	23.1	47.7	48.4	51.5	50.1
		(63.6)	(63.7)		
10,00,000 . . .	38.8	83.0	84.5	91.7	78.5
		(88.1)	(88.8)	(92.2)	
CORPORATE					
25,000 . . .	22	46.9	48.4	43.8	37.2
1,00,000 . . .	22	69.6	70.4	43.8	43.4
10,00,000 . . .	22	81.0	81.6	52.3	43.4

(Source: Economic Trends, January 1953, Tables A and B, pp. 18 and 20.)

NOTE.—Figures in brackets for the years 1944-45 and 1945-46 include E. P. T. and that for the year 1947-48 includes B. P. T.

* Adam Smith, *The Wealth of Nations*.

† Dalton, *Principles of Public Finance*, Ch. XIII, Para. 2.

come and profits, which constituted 23 per cent. of the total Central tax revenue in 1938-39, rose sharply to 68 per cent. in 1944-45 and were 40 per cent. in 1952-53. This is apparent from Table No. 3. II. The incidence of the

TABLE NO. 3. II.

Year	Total Tax Revenue	Total Taxes on Income	Taxes on Income as Percentage of Total Tax Revenue	Number of Income-tax payers as Percentage of total Population
	Crores of Rs.	Crores of Rs.	per cent	per cent
1938-39	76.35	17.28	23	0.08
1939-40	81.85	19.37	24	0.07
1944-45	280.86	191.24	68	0.11
1946-47	300.58	157.00	52	0.11
1947-48*	191.79	115.90	60	0.09
1952-53	429.11	176.00	40	0.13†

(Source : Reserve Bank of India Reports on Currency and Finance 1942-43 to 1952-53 and Central Board of Revenue All-India Income-tax Revenue Statistics.)

tax, as shown in Table No. 1. II, was on a small number of assesseees not exceeding 5 lakhs out of a total population of 34 crores. In other words, the burden of approximately 50 per cent. of the Central tax revenue was put on the shoulders of less than 1/4th of one per cent. of the total population. In addition, customs duties on luxuries and non-essentials contributing a third of the customs revenue were sharply raised and a heavy excise was imposed on fine and superfine cloth. The cumulative impact of all taxes fell with main force on the upper and middle income classes, including entrepreneurs and managers, residing mostly in urban areas. The bulk of the taxes on income and profits, the bulk of the probate duties, the bulk of the customs taxation, especially that on luxuries, and the bulk of the fees and taxes on transactions were heaped on them. These classes bore the brunt of the heavy tax burden, though income of industrial labour and of the agricultural sector and the rural areas rose proportionately higher, if not more. The lower middle class suffered most because of its inelastic standard of living in respect of clothing, housing, conveyance charges, education and the like. The maldistribution resulting from the imposition of such top-heavy taxes on a small sector of the economy consisting of middle and upper class income earners, and on urban areas as distinct from rural areas which benefited largely from the war time rise in incomes had its repercussions on savings, productive efficiency and capital formation. It contributed to the high cost of living and failed to restrain inflation which acted as a peculiarly regressive tax falling most heavily on those least able to pay by reason of their fixed incomes and rigid expenditure schedules. In particular, the middle class was severely penalised and its savings were sequestered. The principle of ability to pay was frequently invoked for this state of affairs but in its broader significance it was largely misapplied.

3. 3. *Authoritative Support.*—The foregoing developments have not passed unnoticed. The Income-tax Investigation Commission comments on the oppressive burden of direct taxes in these words :

"It has been strangely pressed on us that the present rates of income-tax and supertax are so high as to defeat their purpose by discouraging enterprise and by increasing the temptation to conceal business income. It has been added that there is more likelihood of a larger tax income being realised at a moderate rate of tax than at a higher rate. We do not belittle the force of this argument."‡

Further on, the Commission sympathises with the suggestion that, if the Indian income-tax system attempts to follow the main lines of the income-tax law in advanced countries, it must also adopt such of the features of those systems as favour assesseees, and admits that—

"The Indian tax law no doubt exempts a certain limit of income from tax. But there is no denying the fact that this exemption does not properly give effect to the principle of relating the tax to the tax-

payers' "ability to pay". The exemption under the Indian law has no relation to the needs and circumstances of each individual assessee."*

Finally, the Commission acknowledges that in the peculiar position obtaining in India today it is not easy to give effect to the principle of ability to pay and explains the reasons in the following significant terms which can be extended to cover similar other tax burdens :

"If the ability of the assessee is to be properly determined, his whole income, whether agricultural or non-agricultural, will have to be taken into account. But the Indian constitution takes agricultural income out of the sphere of central taxation. Whether it may not be possible to take even agricultural income into account for the purpose of determining the 'ability' of the assessee, though not for the purpose of levying a central tax on such income, is another question. The Ayers Committee recommended that agricultural income might be taken into account for the purpose of determining the rate at which the tax on the other income of the assessee should be computed; even this has not been given effect to."†

3. 4. *Conclusion.*—The inference that can be drawn from the foregoing observations is obvious. What is true of income-tax is also true of other taxes; what is true of the constitutional obstacles is no less true of the pressure of power politics.‡ If, therefore, the Indian tax system is to conform in a sensible measure to the principle of ability to pay in its broader sense, it should undergo a substantial reorientation. The burden of taxation on the small urban areas and the middle and upper income classes must be relieved by transferring a part of it to the large rural areas and the industrial labour and agricultural classes which have benefited in income but have passed over the tax. It is clearly necessary that the field of taxation should be broadened by spreading it evenly on each sector and ensuring that no sector escapes. The burden should also be distributed more equitably by restoring the pre-war proportion of direct to indirect taxes. In a country where direct taxes do not touch an overwhelming majority of the population, collections from suitable indirect taxes are of the utmost importance. It follows that the Indian tax system should be modified in the manner suggested in the concluding paragraphs of the answers to Questions 1 and 2 above.

Question 4.—Differing views have been expressed on the extent to which the taxable capacity of various sections of the community has been used by the Indian tax system. What is your view on the subject?

4. 1. *Function of "taxable Capacity".*—According to the Indian Taxation Enquiry Committee (1924-25), the true test of the relative burden of taxation is—

"The relation of the taxation to the taxable surplus or taxable capacity of the community, which is roughly gauged by the difference between the aggregate income and the aggregate subsistence level, or, to put it in another way, the average income per head minus the minimum of subsistence."§

The Committee further thinks it necessary to take into consideration the distribution of incomes among the community and to know how and where the taxes are spent. It is by no means easy to determine the distribution of income and to allocate the actual benefits of Government expenditure, nor can the minimum of subsistence be readily ascertained in view of the wide variations in the standards of living which in many cases bear no relation to the incomes of the families but depend on the group or sub-group to which they belong. However, taking into account the broad facts of the situation, it may be said that relatively the taxable capacity of the upper and middle income urban classes has been over-exploited in comparison with that of other groups whose income has seen the largest rise since the outbreak of war.

4. 2. *"Taxable Capacity"—Another Approach.*—Taxable capacity has also been expressed to mean a surplus of production over consumption. Production, like consumption, is an elastic term, but at any given time there is a maximum limit to production beyond which productive capacity gets rapidly exhausted in the process of creating a surplus out of absence of renewal, replacement and rehabilitation. In this direction, there is reason to believe that, because of extreme income and profit taxation and other heavy and onerous burdens, the productive machinery in the hands of industrialists,

* *Ibid.* Sec. II, Para. 16.

† Income-tax Investigation Commission (1949), Sec. II, Para. 16.

‡ See Para. 16 above.

§ Report of the Indian Taxation Enquiry Committee (1924-25), Ch. XIV, Para. 478.

* From 15th August, 1947, to 31st March, 1948.

† For 1950-51.

‡ Report of the Income-tax Investigation Commission (1949), Sec. II, Para. 15.

businessmen and traders has suffered from non-replacement of old capital and non-formation of new capital. On the other side, at any given time, the standard of living to which a group or class is accustomed cannot be pushed down indefinitely without doing harm to productivity. Here again, there is reason to fear that the urban middle classes consisting of employed and salaried groups and professional persons have been hit hard, particularly because of the steep rise in the cost of living without any compensatory rise in their incomes. In contrast, the industrial working classes whose incomes have gone up in recent years and who have been the recipients of numerous benefits have contributed little to the tax revenue. Similarly, because of the insensitivity of land revenue to changes in income, the tax contribution of agriculturists has not kept pace with the improvement in their circumstances.

4. 3. *The Limit of Taxable Capacity.*—It is now generally recognised that taxable capacity is not an absolute or fixed quantity. Its limit, at any given time, is influenced by several factors; amongst them the following listed by Sir Josiah Stamp:

- (1) It depends upon what taxation is to be used for.
- (2) It depends on the spirit and national psychology of the people taxed, which may be influenced by patriotism or sentiment.
- (3) It depends partly on the way the taxation is raised, both as to methods adopted and the rate at which the increase is laid on.
- (4) It depends on the distribution of wealth.
- (5) Its rate of increase is greater than the rate of increase in wealth and it shrinks more rapidly than wealth diminishes”.*

The second consideration set out above operates equally in every sector, but if the other tests are applied to the present situation, most of them lead to the same conclusion, namely, that taxation must now turn away from the urban middle and upper classes. In fact, in the current state of the country's economy, taxation seems to have reached the limiting point beyond which additional imposts are likely to bring progressively diminishing returns. Any significant improvement in the position requires a more constructive approach as an increase in taxable capacity can only come about by creating conditions favourable for rapid economic development and industrial expansion through encouragement of savings, investment and capital formation.

Question 5.—The proportion of tax revenue to national income in India is considered small relatively to several other countries. Do you think this proportion can be raised, and, if so, what tax changes would you suggest for the purpose?

5. 1. *Factors Affecting Proportion of Tax Revenue to National Income.*—Table No. 5. I below sets out the proportion which tax revenue bears to national income in respect of various countries. The percentage is the smallest for India and that has been frequently a matter of adverse comment. However, the magnitude

of the national income is not by itself a true criterion of taxable capacity. As pointed out earlier, the total population and the distribution of wealth as well as the purposes for which taxation is used are among the important considerations which determine the scope for taxation. For example, the national income of Canada is about the same as that of India, but the population is so small, barely 5 per cent. that of India, that the scope for larger national savings and higher taxation is unquestionably greater than in India. It is not the size of the national income but of the *per capita* income which is significant from the point of view of tax revenue. As is apparent from Table No. 1. I, a large national income does not necessarily mean a large *per capita* income. This fact must be taken into account. It is for this reason the Planning Commission says that—

“Yields from taxation depend not only on the facilities for collection afforded by particular structural factors (as when corporate incomes are a large proportion of the national income or foreign trade accounts for a considerable part of the transactions) but also on the absolute levels of *per capita* incomes.”*

5. 2. *Influence of Economic Development on Revenue and National Income.*—The stage of a country's economic development exercises a powerful influence on its revenue receipts in more than one way. The Planning Commission has referred in the quotation cited in the preceding paragraph to the dependence of tax yields on structural factors. It concludes the point with the following observation:

“Much also depends on the importance of monetary transactions in the economy; when a large part of the production is raised by the labour of peasant families and directly consumed by them, the scope for organising taxation would be obviously smaller than if the operations were being conducted through markets and result in monetary transactions”.*

This comment is particularly applicable to an under-developed economy like that of India. But there is a much more fundamental limitation than these structural shortcomings in the mechanics of revenue collection. An under-developed economy produces relatively so little per head that it imposes a severe restriction on the field which can be farmed for taxes. The principle of ability to pay has relevance not only for individuals but also for communities taken as a whole. It is well known that the smaller the national product the greater the percentage of personal consumption expenditure to the national income and therefore the smaller the percentage of national income available for taxation. This is clearly brought out in Table No. 5. II (Page 24). The inference to be drawn from the Table is summed up by the Statistical Office of the U. N. in the following terms:

“Another interesting feature of the Table is the light that it throws on the relationship between a country's stage of economic development and the

TABLE No. 5. I.

(Year : 1948-49)

Country	Total Population	Total Revenue	National Income	Per Capita Income	Total Revenue as Percentage of National Income
	Mn.	1,000 Mn. Rs.	1,000 Mn. Rs.	Rs.	per cent
U.K.	50	53.4	137	2,774	40
New Zealand	2	1.4	5	2,440	29
Australia	8	5.1	21	2,682	25
Canada	13	9.2	42	3,157	22
U.S.S.R.†	193	38.7	197	1,020	20
South Africa	12	1.9	11	930	17
U.S.A.	147	126.6	738	5,044	17
India	342	3.7	87	255	4

(Source : Reserve Bank of India Report on Currency and Finance, 1951-52, Statement 6. pp. 134-36.)

* Sir Josiah Stamp, “Wealth and Taxable Capacity”, p. 118.

† Year—1946.

TABLE No. 5.II.

(Year : 1948)

Country	Personal Consumption Expenditure as Percentage of National Expenditure per cent
Norway	59.8
Sweden	62.9
Canada	64.8
Australia	65.0
Germany	65.9
Japan	67.5
U.S.A.	68.7
Denmark	70.5
Netherlands	70.8
U.K.	71.3
New Zealand	71.5
France	73.2

* The First Five Year Plan, Ch. III, Para. 10.

TABLE No. 5. II—contd.

Country	Personal Consumption Expenditure as Percentage of National Expenditure per cent
India*	80 Approx.
Ceylon	81.0
Ireland	81.8
Peru	81.9
Burma	82.3
Guatemala	82.3
Colombia	82.6
Chile	86.0
Philippines	86.5
Mexico	87.4
Puerto Rico	88.8

(Source : U. N. Monthly Bulletin of Statistics, June 1953, introduction, pp. x-xiv).

composition of its national expenditure. The figures clearly confirm the widespread impression that under-developed countries typically devote much more of their resources to consumption (and less to investment) than do the more highly industrialized nations. In view of the larger real product per head produced in the economically advanced countries, it is evident that considerable resources may be devoted to the process of capital formation without unduly curtailing consumption. In the under-developed economies, however, there exists very little margin for capital accumulation once the requirements of the population for food and the other necessities of life have been satisfied.*

The data indicates that under-developed countries like India devote more than four-fifths of their total product to personal consumption which cuts deep into the margin available for taxation, saving and capital formation.

* Not included in the U. N. Table. Approximation based on the extremely tentative estimate in the First Report of the National Income Committee, Ch. Para. 5.17, that "out of a national product of Rs. 87 abja in 1948-49, the consumer expenditure on food probably amounted to about Rs. 46 abja or nearly 53 per cent. of the national income" and on the finding of the All-India National Sample Survey, July 1949—June 1950, that 66.31 per cent. of the total consumer expenditure is on food.

† U. N. Monthly Bulletin of Statistics, Introduction, p. ix.

This tendency appears even in advanced countries when the economic situation deteriorates. For example, the percentage of gross personal expenditure to national income in the U. S. A. rose abruptly to 84 during the great depression of 1930's against the normal 65 per cent. Ordinarily, the large national incomes of advanced countries provide ample surplus for large national savings as well as higher taxation. For example, in 1900 public revenues in the U. K. and U. S. A. were only 60 and 80 per cent. higher than in India whereas by 1950 they were nine and twenty times as big. In 1900 the *per capita* revenue in the U. K. was ten times that in India, in 1940 it was forty times and in 1950 fifty times more per head. Over the half century, the *per capita* revenue increased twenty times in the U. K. against six times in India. Taking changes in price level into account, the *per capita* revenue in the U. K. multiplied tenfold from 1900 to 1950 whereas in India it rose only by 40 per cent., being about stationary at that level over the last decade. This marked divergence between the two countries resulted from two contrary tendencies, the rapid expansion of national income in the U. K. and the rapid expansion of population in India. The national income of under-developed countries like India is naturally small, and when the population is large, the margin available for taxation after deducting personal consumption expenditure becomes a small fraction of the gross national income. It is therefore scarcely surprising, and entirely in conformity with world trends, that the percentage of tax revenue to national income in India should be relatively small.

5. 3. *Influence of National Expenditure on the proportion of Revenue to National Income.*—Again, in determining whether the ratio of total revenue to national income is large or small, it is essential to consider how and where the taxes are spent. As the Indian Taxation Enquiry Committee (1924-25) has pointed out—

"The apparently heavy incidence of taxation per head of the population in the Western countries, where on account of the War the internal debt is very large, is not comparable with the burden calculated on the same lines in a country where the internal debt is small. A very large proportion of revenue raised in England is utilized for the payment of interest on the War loans raised in the country itself; in other words, the amount is only transferred from one set of people to another".*

No less important is the increased State expenditure on social services which advanced countries are able to afford. The Planning Commission has recognised that—

"These high proportions are, of course, a reflection of the large transactions from the public to the private sector through social insurance schemes and servicing up public debt."†

The rapid rise in the proportion of revenue to national income recorded in many countries in recent years is traced in Table No. 5. III. The sharp increase that has taken place in the U. K., public expenditure being 41 per cent. of the national income in 1951-52 against 20 per cent. in 1938-39, is particularly noticeable. This was the result of a striking expansion of social and economic security services. The budget estimates under these heads for the U. K. and India in 1949-50 are set

* Report of the Indian Taxation Enquiry Committee. Ch. XIV, Para. 478.

† The First Five Year Plan, Ch. II, Para. 31.

TABLE No. 5. III.

Country	Total Revenue as Percentage of National Income							
	1938-39	1945-46	1946-47	1947-48	1948-49	1949-50	1950-51	1951-52
Australia	12	27	27	23	25	22	31	31
Canada	12	31	31	26	22	20	21	25
New Zealand	19	17	20	28	29	26	25	..
South Africa	13	20	..	18	17	16	..	..
U.K.	20	37	40	42	40	37	16	41
U.S.A.	8	22	22	21	17	17	20	23

(Source : Reserve Bank of India Report on Currency and Finance, 1951-52, Statement 6, pp. 134-36.)

down in Table No. 5. IV which bring out the contrasting extremes. The amount spent on social services by the Central and State Governments in India was Rs. 9 crores, that is, Rs. 3 per head in 1900 and the corresponding figures for 1950 were Rs. 64 crores and Rs. 2 per head. The parallel *per capita* expenditure by the Central Government in the U. K. was £1 in 1900 and £23 in 1948, the rise in terms of national income being from

TABLE No. 5. IV.

(Year: 1949-50)

Heads of Expenditure on Social Services	Total Expenditure		Per Capita Expenditure	
	U.K.	India	U.K.	India
	Crores of Rs.	Crores of Rs.	Rs.	Rs.
Education	223	43	45	1.2
Health and Medical Services	516	21	103	0.6
National Insurance	189	..	38	..
National Assistance	71	..	14	..
Family Allowance	84	..	17	..
Nutrition Services	81	..	16	..
Other Social Services	381	..	76	..
Total	1,545	64	309	1.8
Total Expenditure	4,395	604		
Percentage of Social Services Expenditure of Total Expenditure	35%	11%		
Population in Crores	5	35		

(Source: U. K. Annual Abstract of Statistics, No. 89, 1952, Table 50, p. 47, and U. N. Public Finance Surveys—India (1951), Ch. V, Table 2.)

2 per cent. in 1900 to 13 per cent.* in 1950. The corresponding percentages for defence were 8 and 13 whereas in India the percentage devoted to defence expenditure was manyfold that for social services even in 1950. This is reflected in Table No. 5. V which shows that India has normally to spend on defence what other countries do not spend except in periods of national emergency, e.g., the Second World War (1945-46) or the Korean

TABLE No. 5. V.

Country	Defence Expenditure as Percentage of Total National Expenditure			
	1938-39	1945-46	1949-50	1951-52
Australia	36	78	33	34
Canada	6	78	19	40
Ceylon	4	2	1	..
India	50	74	47	45
New Zealand . . . . .	..	..	8	16
South Africa	3	63	11†	..
U.K.	29	81	22	27
U.S.A.	13	81	31	56

(Source: Reserve Bank of India Report on Currency and Finance, 1951-52, Statement 6, pp. 134-36).

* The consolidated current expenditure on social services by public authorities (including the Central Government) amounted to £ 1,460 Mn. or Rs. 1,950 crores in 1949-50. (U. K. Annual Abstract of Statistics, No. 89, 1952, Table 49, p. 47).

† For 1947-48.

War (1951-52). This preponderance of expenditure on defence, internal security and general administration is in strong contrast to the meagre outlays on essential social services of public health, medical services and education. The content and quality of public expenditure are of importance in determining the burden of taxation and the foregoing facts cannot be ignored when comparing the proportion of tax revenue to national income in India relating to other countries.

5. 4. Conclusion.—It is no doubt true that the proportion of tax revenue to national income in India is small, but in relation to the net taxable surplus, the ratio is perhaps too high. It may even be said that public revenues raised for inflexible expenditure which do not yield a productive return cause undue hardship; they tend to sap the savings of the community, cut essential expenditure in the private sector so necessary for offering useful employment and even reduce bare consumption expenditure in a country not addicted to luxury living. The commercial and industrial revolutions which have transformed western economies have barely touched the fringe of India. They hold the key to the disparities in tax revenues and the national income scale. The proportion can be raised only when the national income rises in real terms. Obviously, progress in this direction will be difficult to achieve unless tax changes increase the margin of savings and offer suitable encouragement and incentives to investment and capital formation.

Question 6.—Do you think that the relative place of direct and indirect taxes in the Indian tax system is satisfactory?

6. 1. Distinction between Direct and Indirect Taxes.—The distinction generally drawn between a direct and an indirect tax is that the former cannot be shifted whereas the latter can be passed on. Generally, on the principle of ability to pay, direct taxes require the rich to make progressively larger contributions than the poor in relation to their respective incomes whereas most indirect taxes fall equally on the rich and the poor alike. The question of apportioning the relative burdens of taxation between these two heads therefore assumes considerable importance.

6. 2. Gladstonian Principle of Parity.—Gladstone, as Chancellor of the Exchequer, compared direct and indirect taxes to "two attractive sisters" and believed that to be perfectly impartial it was "not only allowable, but even an act of duty, to pay address to them both". This notion of keeping the balance between the two has persisted on the assumption that it maintains a proper distribution of the burden of taxation between various classes. But, in fact, the proportion has had to vary from country to country and time to time.

6. 3. Essentials of a Proper Distribution.—Direct taxes may be preferred in that they stick where they fall and can be made to conform more closely to the principle of ability to pay. Accordingly, when such taxes can be made to cover a sufficiently large portion of the population, the proportion of direct to indirect tax revenues must rise. On the other hand, when their coverage is small, the proportion must fall because to provide the same total revenue as before the rates would have to be steepened up to the point at which they would seriously check the desire and the ability to work and to save, thereby impeding production, saving and capital formation. In such cases, a larger proportion of indirect taxes would seem to obviate the imperfections of direct taxes on income and profits and bring a greater measure of distributive justice.

6. 4. Changes in the Structure of Taxation.—The changing structure of taxation in India is revealed in Table No. 6. I which gives total receipts under various

TABLE No. 6. I.

Heads of Revenue	Percentage to Total Tax Revenue									
	1883-84	1903-04	1913-14	1923-24	1937-38	1944-45	1946-47	1950-51	1951-52	1952-53
Land Revenue	53.2	42.8	35.4	20.8	19.8	7.9	7.0	8.2	7.3	9.5
Taxes on Income	1.3	2.9	3.5	12.3	11.8	48.0	36.6	28.2	24.6	24.6
Customs	3.0	9.2	13.0	24.3	34.1	10.2	20.8	25.0	31.7	25.5
Central Excises . . . . .	..	..	..	..	5.7	9.5	9.7	10.7	11.5	13.3
State Excises	25.1	25.0	23.0	21.7	10.9	11.4	11.9	7.8	7.0	7.4
Stamps	9.5	9.4	11.0	9.0	8.2	4.1	4.6	3.8	3.3	3.7
Sales Tax . . . . .	..	..	..	..	..	2.2	3.0	8.8	7.2	8.2
Other Taxes	7.9	10.7	14.1	11.9	9.5	6.7	6.4	6.5	7.4	7.8
Total Tax—Revenue in Crores of Rs. . . . .	..	..	..	..	134	401	443	630	731	646

(Source: Report of the Indian Taxation Enquiry Committee, 1924-25, Para. 496 p. 351, and Report of the Finance Commission, 1952, Ch. III, Table B, p. 40 and Table B, p. 55.)

heads of revenue. The Table shows at a glance the revolutionary change that has taken place. The proportion of different taxes to the total revenue has altered radically. Land revenue which was the principal source of income in the early years has steadily dwindled from 53 per cent. in 1883-84 to 9 per cent. in 1952-53. Over the same period, income-tax and customs have advanced from less than 3 per cent. to 25 per cent. each in 1953, the proportion rising sharply after 1938-39. On the other hand, excises have fallen off steadily in recent years, especially because of the abolition of the salt duty and the enforcement of the policy prohibition. Its place has been taken by Sales Tax, which has gained increasing prominence as a principal source of State finance. In order to determine the relative place of direct and indirect taxes, it is necessary to analyse these main tax heads in some detail.

6. 5. *Disproportionate Burden of Taxes on Income.*—Direct taxes comprise taxes on income, personal and corporate, and possibly land revenue. Though a larger volume of income has flowed into the agricultural sector in recent years, it has failed to yield any corresponding revenue, as agricultural income has not been effectively taxed. Since agriculture, the country's principal industry, has remained largely outside the field of direct tax, the entire burden has fallen on those engaged in other industries which comparatively are not widely developed. Income and profit taxes are thus levied, as Tables Nos. 1. II and 3. II show, on an insignificant fraction of the population, the burden falling on less than 6 lakhs out

of a total population of millions. This percentage of income-tax paying population appears from Table No. 1. III to be incredibly small as compared with those of other countries. In other countries, where the burden is spread so wide, a high ratio of direct to indirect taxes is justifiable and parity of collections might be maintained under the two heads, as Gladstone believed. In India, the scanty coverage renders it essential that the ratio of direct to indirect taxes should be substantially lower. During the war years, because of the elasticity of revenue from direct taxes whose volume Government could easily control by increasing the rates and multiplying the taxes on the same base under different names, the proportion of direct to indirect taxes was subjected to a drastic change as recorded in Table No. 6. II. In 1938-39, income-tax constituted 23 per cent. of the total Central tax revenue and this percentage shot up to above 68 in 1944-45. While the base expanded but little, the graduation was steepened at all levels and the rates were pushed up to the ceiling. The imposition of surcharges, E. P. T. and B. P. T. vastly increased the incidence of direct taxes. As a result of concessions since the termination of the war, the weight of direct taxation has been lightened, the proportion of direct to total Central revenue dropping to 40 per cent. in 1952-53. This ratio is far too high and it has been attained by pitching up the level of taxes to a point where they are self-defeating. Table No. 6. III clearly indicates that the percentage of income taken away by income-tax in India is equal to and in places higher

TABLE NO. 6. II.

Year	Central			Central and States		
	Total Tax Revenue Crores of Rs.	Direct Taxes on Income Crores of Rs.	Percentage of Direct Taxes on Income to Total Tax Revenue per cent	Total Tax Revenue Crores of Rs.	Direct Taxes on Income Crores of Rs.	Percentage of Direct Taxes on Income to Total Tax Revenue per cent
1937-38	75.5	15.8	21	134.1	15.3	12
1938-39	76.4	17.3	23	135.4	17.3	13
1944-45	280.9	191.2	68	400.6	192.2	48
1946-47	300.6	157.0	52	443.4	162.0	37
1950-51	404.5	173.2	43	629.5	177.3	28
1951-52	512.8	187.6	37	730.6	192.0	26
1952-53	429.1	170.0	40	646.3	174.4	27

(Source : Reserve Bank of India Reports on Currency and Finance, 1942-43 to 1952-53 and Report of the Finance Commission, 1952, Ch. III, Tables B, pp. 40 and 55).

TABLE NO. 6. III

Country		*Tax Percentage to Income of Rs.				
		5,000	10,000	25,000	1,00,000	10,00,000
India	(1)	2.3	5.1	13.2	50.1	78.5
U. K.	(1)	0.0	5.8	23.2	58.2	92.8
U. S. A.	(1)	0.0	0.0	11.4	31.6	78.2
France	(1)	10.2	16.6	25.6	33.9	71.8
Australia	(2)	1.5	7.8	22.5	53.7	72.8
Sweden	(2)	4.7	10.1	22.6	44.0	66.4
South Africa	(3)	0.0	0.0	6.1	28.4	69.1
Canada	(3)	0.0	0.0	8.1	27.3	60.1
Japan	(2)	31.0	50.0	55.0	55.0	55.0
Egypt	(2)	0.0	0.0	3.0	12.5	48.2
Brazil	(2)	0.0	0.0	0.8	9.5	35.4

(Source : Economic Trends, April 1952, Table D, p. 15.)

*Paid by married person with two children (1) 1952 (2) 1951 (3) 1950—Year.

than the tax taken away at the same levels in some of the other countries of the world which are more advanced industrially. In fact, the taxes in other countries are substantially lower than those appearing in Table No. 6. III because, unlike as in India, provision

exists there for suitable relief in respect of dependants, old age, medical assistance, children's education and so on. Besides, the exemption limits are higher and the maximum rates at high level lower as, for example, 77 per cent. in the U. S. A., 70 per cent. in Sweden,

38 per cent. in Australia, 62 per cent. in Denmark and 55 per cent. in Japan. Because of the disproportionately heavy burden of direct taxes on income, the growth of savings has been stultified, capital formation has been retarded and economic progress has been checked. In order that savings may accumulate and investment may fructify, it is necessary that the proportion of direct to indirect taxes should be further reduced and placed on the pre-war level.

6. 7. *Tax Contribution of Import Duties.*—In India, indirect taxes accruing to the Centre consist of excise, import and export duties. The proportion of revenue from this source has risen in recent years due to a more liberal import policy and the increase in the rates of import and export duties after devaluation. The yield

from import duties under important heads for the last few years is reflected in Table No. 6. IV. During the first half of the century, customs' receipts have multiplied thirty times from Rs. 5 crores in 1900 to well over Rs. 150 crores in 1950. Before the war, the revenue was static, but after 1945 there has been a striking increase of more than Rs. 100 crores. This expansion in revenue, despite the policy of protection, indicates successful dovetailing of the restrictive and revenue aspects of Indian tariffs. At present, the normal rate of import duties is 25 per cent. *plus* 5 per cent. surcharge, though luxury goods are charged to higher rates upto 100 per cent., while industrial raw materials, textile machinery and raw films bear a smaller tax. The continuance of the policy of protection ensures for import duties a place of pre-eminence.

TABLE No. 6. IV.

(Crores of Rs.)

Import Duties on	1941-42	1944-45	1945-46	1946-47	1948-49	1949-50	1950-51	1951-52	1952-53
Oils and Motor Spirit	9.8	61.5	71.7	16.2	13.5	19.7	25.4	35.5	38.4
Machinery, Metals, etc. . . .	3.3	3.8	7.8	11.2	14.2	11.2	11.7	16.8	14.1
Raw cotton, raw silk, cotton and silk yarn, etc.	3.5	4.0	4.7	6.4	8.8	10.3	8.7	15.3	9.5
Textiles	2.8	0.9	1.9	8.2	5.0	5.4	0.9	1.5	1.0
Food and Beverages	2.2	4.0	5.9	7.9	5.5	6.2	6.5	8.0	6.5
Tobacco	2.0	4.6	11.6	8.9	8.8	4.9	4.8	3.6	3.1
Motor Cars and Cycles . . . .	.8	1.0	1.9	3.1	9.1	7.5	10.8	15.1	11.3
Other	13.1	12.2	18.2	29.6	33.5	35.1	33.7	45.8	36.1
Total	37.5	92.0	123.7	91.5	98.4	100.3	102.5	141.6	120.0

(Source : Statistical Abstract, India, 1950, Table No. 81, pp. 255-58, and Explanatory Memorandum on the Budget of the Central Government 1950-51 to 1953-54.)

6. 8. *Tax Contribution of Excise Duties.*—Central Excises have been both a productive and elastic source of revenue, increasing from Rs. 6 crores in 1900 to about Rs. 85 crores in 1952. Here again, there has been a rapid expansion from 1943 when the yield was only Rs. 13 crores. The income under the main excise heads is reflected in Table No. 6. V which shows that tobacco, cotton cloth, matches, sugar and tyres have become important in recent years. As in the case of import duties, a substantial portion of the revenue from excise duties is obtained by charging luxury articles chiefly

consumed by the rich. Even otherwise, the argument that excise duties are regressive, falling heaviest on the low income groups, carries less weight today because of the rise in incomes during the last decade. Excise taxes which exempt basic necessities are less severe than income taxes as they give each recipient some choice as to whether he will spend or save, and do not tax that portion of the income that is saved. An emphasis on indirect taxes, therefore, will not be misplaced.

TABLE No. 6. V.

(Crores of Rs.)

Central Excise Duties on	1941-42	1944-45	1945-46	1946-47	1948-49	1949-50	1950-51	1951-52	1952-53
Motor Spirit	1.7	.2	2.3	1.8	1.4	1.8	2.1	2.1	2.0
Kerosene . . . . .	.6	.5	.4	.3	.2	.2	.3	.3	.3
Coal and Coke . . . . .	.3	1.3	3.5	3.6	1.0	1.3	1.6	1.7	1.7
Iron and Steel . . . . .	.5	.5	.5	.5	.5	.5	.5	.6	.6
Tyres . . . . .	.4	1.1	1.2	.7	2.0	3.6	4.0	6.1	4.8
Cotton Cloth . . . . .	..	..	..	..	.9	12.3	9.3	16.4	12.0
Tobacco . . . . .	..	17.1	20.7	20.3	25.5	28.2	32.0	35.6	34.0
Matches	2.9	5.4	6.4	4.4	7.3	7.6	8.1	8.7	9.0
Sugar	6.7	7.8	5.8	7.0	6.4	7.3	6.5	8.4	9.3
Tea . . . . .	..	1.5	1.9	2.1	3.7	2.5	3.4	4.3	4.0
Coffee . . . . .	..	.2	.3	.2	.5	.5	1.2	.8	.7
Betelnuts . . . . .	..	1.3	1.8	.8	..	..	..	..	..
Vegetable Products . . . . .	..	1.1	1.3	1.3	1.1	2.3	2.2	2.5	2.8
Others . . . . .	.1	.1	.3	..	1.2	.4	2.4	.4	.4
Deduct retention . . . . .	..	..	..	..	1.0	.6	4.0	1.8	1.4
Total	13.2	38.1	46.4	43.0	50.7	67.9	69.6	85.8	80.8

(Source : Report of the Finance Commission, 1952, Appendix IX, Table 12, pp. 196-97, and Explanatory Memorandum on the Budget of the Central Government, 1950-51 to 1953-54.)

6. 9. *Tax Contribution of Export Duties.*—Export duties fall in a different category from import and excise duties. The Central revenue under this head appears in Table No. 6. VI. Export duties are levied on commodities for which India is a principal supplier in world markets. These duties were sharply increased after devaluation to intercept windfall gains, but their retention has tended to handicap trade by reducing the competitive capacity of indigenous producers in foreign markets, as in textiles and tea. It is not the foreigner who always pays the export duty, and even in the case of a monopoly like jute, an inordinately heavy tax has encouraged foreign manufacture and stimulated the use of substitutes. It is clear that export duties should, as a rule, be sparingly used and in any case the rates

should be most moderate. The Export Promotion Committee (1949) has given the following advice—

"It should be realised that to rely on export duties as a stable source of revenue is most unsafe and indeed opposed to every canon of fiscal prudence. To put a tax on some exportable commodity in order to meet a budget deficit is to injure the export trade and thus inflict much more damage on the fiscal system than the revenue brought in by the tax can repair."*

The scope for revenue under this head is therefore strictly limited.

* Report of the Export Promotion Committee, 1949, Part II, Sec. 3, Para. 3, pp. 16-17.

TABLE No. 6. VI.

(Crores of Rs.)

Export Duties on	1941-42	1945-46	1946-47	1947-48	1948-49	1949-50	1950-51	1951-52	1952-53
Raw jute	0.8	0.9	1.8	1.8	1.2	1.3	21.0	59.3	20.0
Manufactured jute	2.4	1.7	2.7	4.8	6.4	8.8			
Raw cotton	—	—	0.6	4.0	1.8	2.2	2.5	8.0	10.0
Cotton cloth and yarn	—	0.9	0.8	2.1	4.0	0.4	—	3.3	6.6
Oil and Oil seeds	—	—	—	0.5	1.5	0.5	—	1.5	2.0
Tea	—	—	1.0	7.1	10.8	11.0	10.3	10.2	10.5
Black Pepper	—	—	—	—	—	—	3.3	4.6	2.8
Others	0.4	0.3	0.3	0.2	0.7	1.6	3.4	3.8	3.6
Total	3.6	3.8	7.2	20.5	26.4	25.8	40.5	90.7	5.55

(Source : Statistical Abstract, India, 1950, Table 81, pp. 257-58, and Explanatory Memorandum on the Budget of the Central Government, 1950-51 to 1952-54.)

6. 10. *State Revenue Predominantly from Indirect Taxes.*—The State tax revenue is almost wholly derived from indirect taxes, as agricultural income-tax has been scarcely exploited and land revenue has remained almost completely static. The proportions of the principal heads of revenue are set out in Table No. 6. VII. Since the rate of land revenue has been broadly fixed proportionate to the area, irrespective of yield or income, the tax base has become rigid and inelastic. The larger income of the agricultural sector in the last decade has failed to yield any corresponding return. A thorough-

going revision of land revenue is obviously necessary if the tax burden is to be properly distributed. Till recent years, excise, mainly on intoxicants, was the most important tax, but on account of the introduction of prohibition, it has fallen off rapidly. In view of its revenue possibilities and the current financial needs, the extension or even the continuance of the policy requires reconsideration. Instead of excise, sales tax now takes the pride of place in State budgets and if properly tended it holds promise of playing as vital a part in State finances as income-tax does at the Centre.

TABLE No. 6. VII.

Heads of State Revenue	Percentage to Total Tax Revenue of Part A States								
	1933-39	1942-43	1943-44	1945-46	1948-49	1949-50	1950-51	1951-52	1952-53
Income tax	6.7	14.7	17.0	18.5	25.4	23.5	24.1	25.5	22.9
Land Revenue	43.1	33.4	24.9	17.6	13.4	13.5	15.7	15.1	18.3
State's Excise	22.2	20.5	22.9	30.8	17.8	13.5	12.8	12.9	16.6
Sales Tax	—	2.1	3.7	6.3	17.1	21.5	23.8	21.9	18.7
Stamps	16.2	12.4	12.1	9.8	8.4	8.0	9.1	8.6	8.1
Other Taxes	11.8	15.9	19.4	17.0	17.9	20.0	14.5	16.0	15.4
Total Tax Revenue in Crores of	59.0	37.8	121.3	173.0	193.1	215.8	211.5	218.2	234.2

(Source : Reserve Bank of India Report on Currency and Finance, 1945-46 to 1952-53.)

6. 11. *Increase in Proportion of Indirect Taxes Necessary.*—The tendency in all parts of the world has been to reduce the burden of direct taxes which put a brake on savings and on the rate of investment and technical progress. Even in a highly industrialised country like the U. K. where almost half the population pays income-tax, the proportion has steadily dwindled from year to year and now stands near 50 per cent. It has been realised that those who benefit from State Services should also contribute towards them to some extent in accordance with their means as reflected in the total consumption of taxed goods. The point has been expressed by the Canadian Finance Minister, Mr. D. C. Abbott, in the following terms:

"Our problem is to get a good balance between taxes on earnings and taxes on spending. Taxes on spending, that is, taxes on commodities, do not adversely affect incentives to produce. In the case of taxes on commodities, government revenue is

obtained not by reducing private income, but by placing a charge on private expenditure of certain kinds. This type of taxation has the advantage that it does not adversely affect the incentives to earn income, that is, to produce, and it does offer the consumer some choice as to whether he will spend, and pay the tax, or whether he will save and to that extent avoid the tax."

It follows that emphasis should now come to rest on indirect taxes. Excise and sales tax broaden the tax base, spread the load, reduce tax avoidance, and tax spending rather than production and saving. It is possible that a wide variety of excise rates may lead to improper discrimination between industries and among consumers. Careful regulation is necessary to ensure uniformity and equity. Similar regulation from the Centre is essential for sales tax in respect of the rates, the commodities taxed and the methods of collection. In fact, a national sales tax levied broadly would meet most

objections and become in time a powerful revenue-raiser. Resumption of salt and liquor excise would also provide a large potential source of revenue. In this manner, the aggregate contribution of indirect taxes to total revenue may be increased so as to relieve direct taxes on income and profits from a part of their present heavy burden. A rise in the proportion of indirect to direct taxation would not be inequitable. Sir Josiah Stamp advised the Indian Taxation Enquiry Committee in 1924-25 that—

“A light poll tax seems not unsuitable in Indian conditions”*

The current economic situation, in its essence, is not very different from what it was in those days. A return to the pre-war proportion is clearly indicated if the relative place of direct and indirect taxes in the Indian tax system is to rest on a more satisfactory basis.

Question 7.—Do you consider that non-tax revenues are likely, in future, to occupy a more important place than hitherto in the public revenues of India? If so, please state the sources of non-tax revenue you have in view and indicate to what extent they may be expected to contribute to the public exchequer.

7. 1. Non-tax Revenues.—The present important sources and contributions of non-tax revenues of the Centre are set out in Table No. 7. I. and of the States in Table No. 7. II. Non-tax revenues do not have as much importance in the U. K. or U. S. A. as they have in India, partly because railways, irrigation works, etc.

* Report of the Indian Taxation Enquiry Committee, Ch. III, Para. 31.

TABLE No. 7. I.

Year	Main Heads of Central Non-tax Revenue			Total Central Non-tax Revenue as Percentage of Total Central Revenue, per cent
	Currency and Mint	Railways	Post and Tele-graphs	
	Crores of Rs.	Crores of Rs.	Crores of Rs.	
1938-39	0.58	1.37	0.19	12.5
1940-41	1.94	12.16	1.25	28.3
1942-43	5.25	20.13	4.52	29.5
1943-44	9.97	37.64	9.03	31.5
1945-46	16.75	32.00	11.31	21.9
1946-47	15.75	5.61	4.78	20.0
1948-49	12.63	7.34	2.36	13.9
1950-51	12.27	6.50	3.98	31.1
1951-52	11.30	6.93	3.43	10.7
1952-53	10.77	7.68	1.40	11.1

(Source : Reserve Bank of India Reports on Currency and Finance, 1942-43 to 1952-53.)

TABLE No. 7. II.

Year	Main Heads of State Non-tax Revenue		Total Part A States Non-tax Revenue as Percentage of total Part A States Revenue, per cent
	Forests	Irrigation	
	Crores of Rs.	Crores of Rs.	
1937-38	2.81	9.32	30
1944-45	12.33	13.69	24
1946-47	11.52	13.15	27
1950-51	19.21	7.58	28
1951-52	21.15	8.40	31
1952-53	20.14	8.27	30

(Source : Report of the Finance Commission, 1952, Ch. III, pp. 36-37 and 49, and Reserve Bank of India Reports on Currency and Finance, 1942-43 to 1952-53.)

are privately owned and the public policy regarding rate structure is different. For example, in the U. K. public utilities are run primarily for service and incidentally for revenue. It is otherwise in India, as witness the recent increases in railway and postal rates. The place of the various non-tax heads in the Indian revenue system may be, therefore, briefly examined.

7. 2. Receipts from Currency and Mint.—The Profit from currency and mint has been fairly substantial in recent years. It is however in the nature of a tax incidental to inflation. The contribution from this source will be maintained as long as there is recourse to inflation through deficit financing. But that carries within itself seeds of disintegration if indefinitely pursued and the revenue under this head may therefore be expected to decline with the passage of time.

7. 3. Railway Contributions.—The Railways with a capital at charge of over Rs. 800 crores have made substantial contributions, largely because of the enormous increase in passenger traffic in recent years. However, current expenditure has been steadily rising and it is only by a monopoly increase in railway fares, recently of the order of 20 to 25 per cent., that the contribution has been kept up. The surplus is mainly obtained from third class passengers and this makes it obvious that the higher rates on railway traffic are regressive in character. But a good portion of the additional finance raised is being used for development purposes, and if there is efficient and economic management, the contributions to general revenues under this head may show a marked improvement.

7. 4. Posts and Telegraphs Contributions.—After reaching their peak in the war period, the contributions of Posts and Telegraphs have been steadily dropping off in recent years in the same manner as those of Railways. It may perhaps be that the point of diminishing returns has been reached and that the increases in postal rates have been exercising a restrictive effect. If the rates are suitably adjusted and if wasteful expenditure is curbed, the receipts under this head may improve a little but there appear to be few prospects of any large contributions to the general revenues.

7. 5. Forests and Irrigation Revenue.—The Revenues from forests and irrigation mainly belong to the States. The yield from irrigation has been almost static over a number of years but that from forests has been remarkably productive. There is a large potential source of revenue in the form of royalties and other fees if forests, fisheries, and the mineral and other underground wealth of the country are properly exploited. Receipts under this head may therefore show notable progress if there is systematic development of the country's natural resources.

7. 6. Revenues from Development Projects.—The revenues from development projects have so far been disappointing and it is a question what the future contributions to revenue under this head will be. The river valley projects have apparently been proceeded with without strict investigation or proper assessment—the Minister for Natural Resources and Scientific Research had occasion to admit that the original estimates of D. V. C. were “more or less guess-work”. Nor has the execution of these schemes been efficient or economic and Auditors' reports have referred to absence of competitive tenders, heavy expenditures enormously exceeding estimates, and wastages and excessive overhead costs. D. V. C., Bhakra-Nangal, Hirakud and other important projects are expected to produce large output of foodgrains and increase revenue yields from income-tax and sales tax. But overcapitalization and the top-heavy expenditures incurred lead to doubts whether they will contribute anything much to the general revenues in the near future.

7. 7. Revenue from State Industrial Undertakings.—The record of State industrial undertakings to date has been far from satisfactory. The Pre-Fabricated Housing Factory has been an outright failure, apparently involving a loss of almost a crore of Rupees. The Mepa Mills have turned out to be a financially costly business giving no yield. Industrial undertakings like the Sindri Fertilizer Factory which has gone into production with some prospect of return have been severely criticised by the Estimates Committee for their heavy costs exceeding original estimates by as much as hundred per cent. The Railway Collieries have proved uneconomic and are reported to be suffering an annual loss of a crore of Rupees. The nationalised transport, telephone and electricity undertakings have been inefficient and costly to the public, the surplus achieved being largely the result of monopoly rates and charges. Several other State enterprises like the Indian Telephone Industries, The Machine Tools Factory, the Chittaranjan Locomotive Factory, the Visakhapatnam Shipyard and the Hindustan Aircraft Factory have been making painfully slow progress and hardly any of them have shown substantial profits on their working. The latest example is of the nationalised Civil Aviation industry acquired “on the cheap” from private hands by undermining

their financial position and undervaluing their assets at well below current market prices.

7. 8. *Revenues from State Enterprises.*—It is a matter of grave doubt how the various State enterprises and projects will function in the future and what will be their contributions to the general revenue. Upto now the direct return on a capital expenditure of hundreds of crores has been negligible. It may be conceded that long-range projects cannot be expected to yield short-period returns. But experience so far does not give much cause for optimism and throws doubts whether too high a price is not being paid. Perhaps monopoly undertakings may bring in some yield, but that will be little removed from taxation, pure and simple. The inexperience of Government and the unsuitability and inefficiency of Government machinery will more probably lead to concealed waste of public funds, amounting to the imposition of a heavy fine on the community. The loss of more than half a crore of Rupees reported by the Parliamentary Public Accounts Committee on the State trading scheme relating to the import and sale of Japanese cloth in 1947-48 is a case in point. On the whole, it is the general public, as taxpayer and consumer combined, which loses more than it gains. In the U. K., notwithstanding traditions of patriotism, discipline, sound administration and advanced techniques, the gilt has worn off the ginger-bread of nationalisation. In France, operating losses running into milliards of Francs, general increase in indebtedness and gross overstaffing have converted Government enterprises in coal, gas, shipping, films and the like into monuments of wastage, abuses and even fraud. One can only hope, though without much conviction, that the experiment in India may prove more fortunate and less unprofitable to the general revenues. In any case, the scope for further extension of State activity in the form of trade and industry with the object of earning revenues appears to be severely restricted. As the Planning Commission has observed—

"The scope and need for development are so great that it is best for the public sector to develop those industries in which private enterprise is unable or unwilling to put up the resources required and run the risks involved, leaving the rest of the field free for private enterprise. The nationalisation of the existing enterprises, which means acquisition by Government of existing productive assets has, in our view, only a low priority".*

Question 8.—Do you agree with the view that receipts from particular taxes should not, as a rule, be funded or ear-marked for specific purposes?

8. 1. *Tax Receipts should not be Earmarked.*—In making a practical distinction between taxation and other sources of Government income, Prof. Taussig has suggested that—

"The essence of a tax, as distinguished from other charges by Government, is the absence of a direct *quid pro quo* between the taxpayer and the public authority".†

On this view, which is generally accepted, a tax is a compulsory contribution imposed irrespective of the service rendered to the taxpayer. It therefore follows that receipts from particular taxes should not, as a rule, be funded or earmarked for specific purposes. The principles determining expenditure on various State activities bear little relation to the principles on which taxes are levied. Otherwise, expenditure on several essential public services cannot be incurred because of the impossibility of earning any revenue from those sources.

8. 2. *Special Cases.*—The qualification "as a rule" may be explained. If special taxes are imposed for special purposes as for example, for research or development in relation to an entire trade or industry, the receipts under that head may be separately funded or earmarked. Similarly, if, for instance, the machinery of controls is used to compel an industry to part with its product at a price lower than the corresponding imported article, the difference may be absorbed by a special tax. In that event, the proceeds of such a special tax may be earmarked for the benefit of the industry concerned by helping it with research or in enlarging its productive capacity. Special taxes of the more familiar variety are referred to in the answer to the following question, but subject to those exceptions, it may be allowed that by and large all tax receipts should be utilized for general purposes.

Question 9.—Do you think that it is desirable, under certain conditions, to levy cesses for special purposes?

9. 1. *Cesses for Special Purposes.*—A cess may be levied on a commodity or economic activity provided the trade or industry has the capacity to bear the tax and provided further the expenditure incurred out of the cess receipts can be utilised for securing some substantial benefit or advantage for that trade or industry as a

whole, say, by improving its productivity or the quality of its output or products, or by promoting special economic in production, or by increasing its earning power, or by expanding its markets or productive capacity. Examples of this can be seen in the cess on cotton and sugar for furtherance of research with a view to improving the quality and yield of the product, or the cess on tea designed for promotion of exports through publicity and propaganda in order to exploit and retain world markets on which the prosperity of the tea industry depends.

9. 2. *Some Undesirable Developments.*—The conditions postulated for levy of a cess preclude its imposition when the tax is beyond the capacity of the trade or industry to carry, or when the object is to subject it to a disability or handicap or to utilise its proceeds not to further the interests of the trade or industry taxed but of a different trade or industry. The cess recently clamped on the textile mill industry for the specific purpose of subsidising uneconomic units of the rival handloom industry is repugnant to elementary considerations of justice and equity, no matter how deserving on other grounds the handloom industry may be for receiving public assistance and support. No less undesirable is the diversion in other directions of cess revenue avowedly raised for a special purposes. Referring to the cess on sugar cane, the Fiscal Commission (1949-50) has adversely commented on—

"The levy of Provincial cesses of which only a portion was used for research in improved varieties of cane which was the ostensible purpose for which the cess was imposed".*

The realisation by certain States of sugar cane cess revenue far in excess of the expenditures incurred by them on cane development has meant, in effect, that consumers all over the country have been made to contribute a special tax to the State Governments concerned. The Motor Vehicle Taxation Inquiry Committee has been more forthright on this point. Strongly disapproving the diversion to other uses of the revenues from special road taxes imposed for promoting rapid road development, the Committee has expressed itself as follows:—

"The principle should be recognised that the motor vehicle user, as a general tax payer, should contribute to governmental revenues only to the same extent as the Railway user, and should not be called upon to pay for implementing Union or State policies in matters such as defence, welfare and prohibition".†

9. 3. *Reform Necessary.*—It may be concluded that the procedure and rates applied to the levy of cess on different commodities and in different States should be systematised and made more uniform. It should also be ensured that the proceeds realised from levy of cesses should be spent in their entirety for the purposes for which they are collected. Finally, the purposes for which the cess revenues are raised should be wholly and exclusively for the benefit and advantage of the trade or industry subjected to the tax, which it should be well within the capacity of that trade or industry to bear. Accordingly, the Fiscal Commission (1949-50) has recommended that—

"The levy of cesses for promoting research is unobjectionable so long as the rates are moderate and the whole of the tax is actually spent on research and not directed to other purposes".‡

Question 10.—State undertakings, commercial, industrial, etc., are coming to play an increasingly important part in the economy of the country. Have you, from the point of view of their significance as a source of revenue, actual or potential, any comments or suggestions to make on matters such as the further extension of State undertakings and their policies in regard to pricing, in so far as these may be relevant to tax policy?

10. 1. *Growing Importance of State Enterprises.*—State undertakings engaged in commerce, industry and transport have been gaining prominence in the economy of the country and the doubts expressed in answer to Question 7 above cannot gainsay that fact. Whether they will be a burden to the community, as feared, or otherwise, must be left to the test of time and experience. It is the declared policy of Government not to nationalise purely for revenue purposes. Even otherwise, certain points attract comment.

10. 2. *State Undertakings and Taxation.*—Today, Government is in the position of a partner without risks in every private business with a share of about six or seven annas in the Rupee. State undertakings, on the

* Report of the Fiscal Commission (1949-50), Ch. VI, Para. 74.

† Report of the Motor Vehicle Taxation Enquiry Committee, 1950, p. 90.

‡ Report of the Fiscal Commission, 1949-50, Ch. XII, Para. 171.

* The First Five Year Plan, Ch. XXIX, Para. 7.

† Taussig, Principles of Economics, II, p. 483.

other hand, are free from income-tax liability. The loss in tax revenue is certain, and apart from the risks involved it is well worth considering to what extent such loss is made good by contributions in the form of non-tax revenues. The more appropriate and proper course is to subject State undertakings to tax in the same manner and to the same extent as similar private enterprises.

10. 3. *Management of State Enterprises on Business Lines.*—It is necessary that not only should the profits of State undertakings be taxed; the undertakings themselves should be run on the lines of private enterprise if waste is to be avoided and efficiency maintained. They should observe the distinction between capital and revenue accounts and proper accounting methods should be employed, as in private business, for computing costs and providing for depreciation, replacement and general reserves. The present position is obscure. The statements of accounts and balance sheets of those State undertakings which are working as private limited companies are not available for public scrutiny; nor are their affairs under Parliamentary control. A more satisfactory basis for "accountability" must be evolved.

10. 4. *Pricing Policy.*—Even when State undertaking, conform to accepted business standards, it will be difficult to judge whether they are being efficiently managed and whether the prices they charge for their goods and services do not contain an element of taxation. State undertakings, particularly public utility services, tend to be monopolies. They are entitled, as Bastable* pointed out to the U. K. Royal Commission on Local Taxation (1897), to earn ordinary profit on the capital employed, but the surplus or monopoly profit is a kind of taxation falling not on the public as a whole but only on the particular section served by the undertaking. Sidgwick† was of the view that it is necessary to consider not how much the consumer pays beyond what the services rendered by the State managed industries cost but how much is paid beyond what consumers would have had to pay in conditions of competitive private enterprise. Consideration of cost and utility afford little guidance in the determination of such rates. It has therefore been suggested that the pricing policy should be entrusted to an independent and competent body on whose decisions should "beat the light of publicity far fiercer than any that has ever beat on a throne". But there is little doubt that the protection available to consumers under a system of competitive prices such as a private proprietor or business concern might charge under competitive conditions for the use of property or supply of goods or services will in time fade away. Governments have extravagant taste and their methods are slow and cumbrous. In practice, as experience teaches, the plea of public service will be used to cover a multitude of sins and the power to charge what the traffic will bear will be wielded in the same manner as the taxing authority of the State itself—without, perhaps, any of the checks resembling parliamentary and ministerial responsibility to the elected representatives of the people.

10. 5. *Dangers of Government Monopolies.*—The vested interests in industry have often been denounced. But at least, as the Planning Commission has pointed out.

"There is no such thing under present conditions as completely unregulated and free private enterprise"‡

It is time to recognise that there are far greater vested interests in Government which are the more dangerous because of the monopoly position from which they operate. In activities like defence or public utilities like Railways, where private enterprise cannot function effectively, Government participation may be accepted, though even there the expenditure incurred may not be viewed without distrust. But in other directions, the strong bias in favour of the public sector must be reconsidered. All its failings notwithstanding, the private sector is better fitted to undertake the tasks of investment and production and more capable of giving better worth.

Question 11.—Would you suggest that the net surplus earned by State undertakings should accrue to general revenues or be carried to a fund for financing projects of development or be re-invested in the undertakings concerned?

11. 1. *Revenue from State Undertakings.*—The fiscal aspect of the activities of State undertakings is of great importance. The validity of any policy that aims at getting revenue for the treasury from the working of these enterprises is not generally disputed but what should be the basis and quantum of such contributions are matters on which opinions differ.

* See Report of the Indian Taxation Enquiry Committee, 1924-25, Ch. II, Para. 17.

† See Report of the Indian Taxation Enquiry Committee, 1924-25, Ch. II, Para. 17.

‡ The First Five Year Plan, Ch. II, Para. 16.

11. 2. *Profits from Competitive and Monopoly Profits.*—A distinction may be attempted between State undertakings earning the equivalent of profits from ordinary competitive prices and those deliberately charging monopoly prices for their goods and services, which is the equivalent of taxation. It seems that the surplus resulting in either case might first be reinvested in the undertakings concerned if such investment is necessary or desirable for enabling them to work at an optimum level or for meeting the needs of the community through expansion of output and production. Should this be not necessary, the major part of the surplus earned by charging competitive prices may, with advantage, be carried to a fund for financing development project. If the surplus is of State undertakings enjoying a monopoly, the excess charged is in the nature of a concealed tax on the consumers served by those undertakings. In such cases, if the consumers are not restricted to a particular section but spread over the population at large, as in the case of Railways and Posts and Telegraphs, there is justification for diverting a substantial portion of the surplus to the general revenues. Where the consumers form a more restricted group, it is far from desirable that the State undertaking should exploit its monopoly and create a large surplus, for in the process wastage and extravagance are bound to be encouraged and the charge falls on a body of people who, from the point of view of equity and ability, may be the least fit to bear the burden but who nevertheless cannot escape the tax.

11. 3. *Element of Arbitrariness.*—As pointed out in the answer to Question 10 above, it is difficult to avoid the element of arbitrariness in the pricing policy of most State undertakings. If faced with a deficit in competition with private enterprise, they are likely to secure special privileges and concessions as well as sponge on the general revenues. Accordingly, when a surplus appears, the general reserves may well claim a contribution and, subject to the reservations expressed in the preceding paragraph, the quantum of such contribution should vary directly with the magnitude of the monopoly element entering in the pricing factor. In practice, therefore, the question of how much of a surplus in a particular case should accrue to the general revenues is likely to be a matter of widely differing views.

Question 12.—In examining the incidence of taxation on various classes of people, which of the following factors singly or in combination, would you suggest as the basis of differentiation—(a) income, (b) occupation, (c) rural or urban residence?

Is there any other basis which may be considered?

12. 1. *Basis of Differentiation.*—The division of a mass into classes is useful provided the classes are broadly homogeneous and distinguishable from one another by an identifiable characteristic. For purposes of examining the incidence of taxation, the distribution of income amongst the community is the most important consideration. In India, however, the comparatively rigid stratification of the population into social and religious groups wedded to fixed habits and ways of life introduces complications which, for example, do not exist in the U. S. A. where relatively greater vertical mobility predominates. Again, conditions in rural areas are markedly different from those in the urban areas which have become more modernised and consume a large part of the imports subject to customs duty. Much more important is the practical exemption of agricultural income from income-tax. It therefore follows that, apart from income, which is the main factor, occupation and rural or urban residence also require some consideration when examining the incidence of taxation.

12. 2. *Main Classes.*—The main classes distinguished by the Indian Taxation Enquiry Committee (1924-25) are tabulated* by occupation and residence as under:

Urban		Rural
1. Industrial Labour (including low grade artisans)		Landless Agricultural labourers (including low grade artisans)
2. The Town Trader (small)		The Village Trader
3. Professional Classes—Lower Grade—(Clerical, Subordinate officials and lower range of professional men)		The Small Holder (ryot or tenant)
4. Professional Classes—Upper Grade—and the Town Trader		The Peasant Proprietor (with a substantial holding)
5. Big Merchants and Industrialists		Big Landlords and Zamindars

* Report of the Indian Taxation Enquiry Committee, Ch. XIV, Para. 421, pp. 340-41.

This horizontal and vertical classification on the basis of occupation and residence gives groups which are subject to wide variations not only in income but also in spending, saving and investment habits comprised in standards of living which do not always correspond to the income earned. For instance, urban industrial labour enjoying high wages and improved amenities is better off than its rural counterpart—the landless agricultural labourers. With all adult male and female members of the family employed, and with small overheads in the matter of housing, clothing, education and the like, industrial labour has also a great advantage over the urban lower middle class. Families in this lower middle class group, supported by a single earner and carrying inelastic overheads, have relatively fixed incomes on which there are increasing drafts as expenditure mounts up with every rise in the cost of living. For much the same reasons, the middle and upper middle classes with well-developed saving and investment habits are less well off than the peasant proprietors with substantial holdings in rural areas. The incomes of the big merchants and industrialists on the one hand and of the big landlords and zamindars on the other may be quantitatively of the same order, but there is little doubt that the urban and rural divisions where these incomes arise lead to differentiation in taking methods which tend to affect the incidence of taxation.

12. 3. *Differentiation and the Principle of Maximum Social Advantage.*—It may be concluded that the present incidence of taxation can be best examined on the basis of differentiation according to income, primarily, with occupation and residence as subsidiary factors. This is not

to endorse the validity the existing basis. Differentiation should be primarily governed by the principle of maximum social advantage. On this approach, there is little reason why urban areas should be discriminated against in favour of rural areas. Spending, saving and investment habits are important and they vary with social groups which are traditionally inclined to engage in certain occupations. To the extent occupation is a good indicator of these habits, it is a useful supplement to the income factor in determining the basis of differentiation when examining the incidence of taxation.

Question 13.—Do you think that the burden of the present tax system—Central, State and Local—is fairly distributed among—(a) various classes of people? different States?

13. 1. *Incidence of Taxation.*—It is difficult to be precise about the present distribution of the tax burden. But subject to such qualifying factors as distribution of income within each class and the objects for which public expenditure is incurred, indications of how the burden bears on the different classes of the community are to be found in their contributions to the Central and State revenues. The extent of the maldistribution has been frequently referred to in the foregoing paragraphs and the broad factors are re-examined in some detail here and in answer to the following Question No. 14.

13. 2. *The Background.*—The distribution of population according to residence in rural and urban areas and agricultural and non-agricultural pursuits is shown in Table No. 13. I;

TABLE NO. 13. I.

(Population in Millions.)

Category of Population	Urban			Rural			Total		
	Non-Agri- cultural	Agri- cultural	Total	Non-Agri- cultural	Agri- cultural	Total	Non-Agri- cultural	Agri- cultural	Total
Self-Supporting . . .	16.4	2.3	18.7 (30%)	17.0	68.7	85.7 (29%)	33.4	71.0	104.4 (29%)
Earning Dependents . .	2.0	.8	2.8 (5%)	4.8	30.3	35.1 (12%)	6.8	31.1	37.9 (11%)
Non-Earning Dependents .	34.8	5.6	40.4 (65%)	32.6	141.4	174.0 (59%)	67.4	147.0	214.4 (60%)
Category Total . . .	53.2 (86%)	8.7 (14%)	61.9 (100%)	54.4 (18%)	240.4 (82%)	294.8 (100%)	107.6 (30%)	249.1 (70%)	356.7 (100%)
Percentage to Total Population	14.9	2.4	17.3	15.3	67.4	82.7	30.2	69.8	100
Working Force—Number of Persons Engaged . . .							42.2 (31.8%)	90.5 (68.2%)	132.7 (100%)
Net Domestic Product in Crores of Rs.							4,580 (52%)	4,150 (48%)	8,730 (100%)
Net Annual Output per Engaged person in Rs. . . .							1,000	500	660

(Source : Census of India, 1951, Paper No. 3, Table No. 4, and First Report of the National Income Committee, April 1951, Ch. V, Table 4, p. 31.)

The total population is 356.7 million, of which more than 40 per cent. is below the age of 14 or above the age of 65. The proportion of rural to urban population is in the ratio of 83 to 17. The proportion of agricultural to non-agricultural population is 70 to 30. The proportion of the estimated total working force in each sector is about the

same, being 68 to 32, but the net value of output per person engaged in agricultural and non-agricultural occupations is in the proportion of 1 to 2, being about Rs. 500 and Rs. 1,000 respectively. The contributions of different types of productive activity to the national income, the size of the working force and the net output per engaged

erson in different branches of each activity appear in table No 13. II. The national income of India for 1948-9 is reckoned at Rs. 8,710 Crores, about 48 per cent. or half of which represents the product of agriculture covering 70 per cent. of the working force and the total popula-

tion of the country. Household enterprises and hand-trades contribute about 10 per cent. of the income and professions and government services contribute another 9 per cent. Industry, commerce, transport and communications amount to 26.8 per cent. or approximately a fourth

TABLE NO. 13. II.

Items	Net Output Crores of Rs.	Percentage to Aggregate Net Output Per cent	Number of Persons engaged Lakhs	Net Output per Engaged Person Rs.
Agriculture—				
(a) Other than Plantations, etc.	4,020			
(b) Plantations and Forestry	130			
	4,150	47.6	905	500
Small Enterprises and Hand-trades	860	9.9	149	600
Large Enterprises—				
(a) Mining and Factory Establishments.	640	7.3	38	1,700
(b) Railways and Communications	230	2.6	12	1,900
(c) Banking and Insurance	50	.6		
(d) Other Commerce and Transport	1,420	16.3	95	1,500
	2,340	26.8		
Professions and Liberal Arts	320	3.7	50	600
Government Services (Administration)	460	5.3	36	1,300
Domestic Service	150	1.7	42	400
House Property	450	5.2		
	8,730	100.2		
Net Domestic Product	—20	—0.2		
Net Earned Income from Abroad				
National Income	8,710	100.0	1,327	660

(Source : First Report of the National Income Committee, April, 1951, Ch. V, Tables 2, 3 and 4.)

of the national income. Considering these facts, the National Income Committee observes as follows:

"When it is remembered that a large part of the commodity production does not enter into trade at all—being retained by the producer for his own consumption—the relative importance of this sector is clear. These figures, taken in conjunction with income-tax returns, may also be of some help in appraising the incidence of taxation on various sectors".*

Actually, in 1948-49, the number of those paying taxes on income and profits was 4.7 lakhs, drawn from the middle and upper class residing mostly in urban areas and constituting less than 1/7 per cent. of the total population, 1 per cent. of the total working force of about 13 crores and 1 per cent. of the non-agricultural working force of 1 crores. This sets the background for measuring the contribution of the various classes to the Central and State revenues.

13. 3. *Distribution of the Tax Burden.*—A consolidated statement showing the receipts under each tax head as a percentage of the total Central and State revenues is presented in Table No. 6. I. The relative contributions of the middle and upper classes on the one hand and of the lower income groups on the other to these total tax revenues is largely a matter of conjecture. The data is extremely fragmentary and all that can be attempted is assignment as under of what are judged to be appropriate percentages giving dimensional indications of the contribution of each class under separate revenue heads:

(a) Taxes on income and profits are obviously paid in full by the middle and upper classes.

(b) Similarly, Central customs duty being, as Table No. 6 IV shows, mostly on industrial goods and raw materials (like raw cotton, raw silk, silk yarn, oils, fuel, motor spirit, metal and machinery of all kinds, etc.) and on articles consumed in urban areas (like foreign spirits and liquors, foreign tobacco, textile fabrics, motor cars, etc.) may be allocated to the extent of 80 per cent. to the urban area and the middle and upper classes.

(c) The consumption of commodities on which Excise Duty is levied is more difficult to trace but, as Table No. 6. V shows, a substantial portion of the duty (as on fine and superfine cloth, tyres, motor spirit, etc.) may be ascribed to the urban area and the middle and upper classes whose share of the total may be put down at 50 per cent.

(d) The share of land revenue borne by the rural middle and upper classes may be set at 75 per cent.

(e) As regards indirect State taxes, an indication of the relative proportions may be gathered from the actual collections made under these heads in the cities of Bombay, Calcutta and Madras from 1948-49 to 1950-51. These are expressed as percentages of the total collections for the entire State in Table No. 13. III. On the basis of the percentages for the three main cities appearing in Table No. 13. III, the share of the urban area and the middle and upper classes may be placed at 40 per cent. for State Excises, 70 per cent. for Sales Tax and 60 per cent. each for Stamps and Other Taxes (comprising Electricity Duty, Entertainment tax, receipts under Motor Vehicles Act, etc.).

TABLE NO. 13. III.

Year	Bombay City	Calcutta	Madras City	Average Percentage
State Excise as Percentage of Total (Excise) State Revenue				
1948-49	30	50	20	
1949-50	26	50	20	
1950-51	50	50	20	
Average	35	50	20	35
Stamp Revenue as Percentage of Total (Stamp) State Revenue				
1948-49	61	57	16	
1949-50	57	56	14	
1950-51	57	53	14	
Average	58	55	15	46
Sales Tax as Percentage of Total (Sales Tax) State Revenue				
1948-49	66	80	26	
1949-50	63	80	23	
1950-51	59	81	23	
Average	63	80	24	56
(Other Taxes as Percentage of Total Other Taxes) State Revenue				
1948-49	73	65	22	
1949-50	55	80	16	
1950-51	47	74	14	
Average	58	73	17	49

* First Report of the National Income Committee, Ch. V, Para. 5. 3, p. 29.

(Source : Report of the Finance Commission, 1952, Appendix IX, Table 11, pp. 194-95.)

The relative contributions of the urban and rural areas and the middle and upper classes and of the lower income groups to the Central and State revenues may be estimated by applying the percentages estimated as above

to the percentage tax collections under each head shown in Table No. 6. I. The results appear as in Table No. IV:

TABLE NO. 13. IV.

		Percentage to Total Central and States Tax Revenue							
		Taxes on Income	Customs Duty	Central Excise	Land Revenue	State Excise	Sales Tax	Staamps	Other Taxes
Proportion A : B		100:0	80:20	50:50	75:25	40:60	70:30	60:40	60:40
1937-38—									
Class A	.	11.8	27.3	2.8	14.9	4.4		4.9	5.7
Class B	.	—	6.8	2.9	4.9	6.5		3.3	3.8
Total	.	11.8	34.1	5.7	19.8	10.9	—	8.2	9.5
1944-45—									
Class A	.	48.0	8.2	4.7	5.9	4.6	1.5	2.5	4.0
Class B	.	—	2.0	4.8	2.0	6.8	.7	1.6	2.7
Total	.	48.0	10.2	9.5	7.9	11.4	2.2	4.1	6.7
1946-47—									
Class A	.	36.6	16.6	4.8	5.3	4.8	2.1	2.8	3.8
Class B	.	—	4.2	4.9	1.7	7.1	.9	1.8	2.6
Total	.	36.6	20.8	9.7	7.0	11.9	3.0	4.6	6.4
1950-51—									
Class A	.	28.2	20.0	5.3	6.2	3.1	6.2	2.3	3.9
Class B	.	—	5.0	5.4	2.0	4.7	2.6	1.5	2.6
Total	.	28.2	25.0	10.7	8.2	7.8	8.8	3.8	6.5
1951-52—									
Class A	.	24.6	25.4	5.7	5.5	2.8	5.0	2.0	4.4
Class B	.	—	6.3	5.8	1.8	4.2	2.2	1.3	3.0
Total	.	24.6	31.7	11.5	7.3	7.0	7.2	3.3	7.4
1952-53—									
Class A	.	24.6	20.4	6.6	7.1	3.0	5.7	2.2	4.7
Class B	.	—	5.1	6.7	2.4	4.4	2.5	1.5	3.1
Total	.	24.6	25.5	13.3	9.5	7.4	8.2	3.7	7.8

NOTE: Class A—Middle and Upper Class.

Class B—Lower Income Groups.

(Based on Table No. 6. I.)

13. 4. *Evidence of Maldistribution of Tax Burden.*—The conclusions that can be tentatively drawn, and which find confirmation in what is said in answer to the following question No. 14, are—

- (a) That the entire burden of direct taxes on income and profits equal to 40 to 50 per cent. of the Central tax revenue and 25 to 30 per cent. of the total Central and State tax revenues falls on a small group of middle and upper class persons residing in urban areas and constituting less than a quarter per cent. of the total population. As the Planning Commission observes:

“A striking feature of the present structure of taxation in India is the relatively narrow range of population affected by it to any appreciable extent. About 28 per cent. of the total tax revenue comes from direct taxation which directly affects only about half of 1 per cent. of the working force in the country estimated at 193 million in 1948-49”.*

- (b) That the burden of about 80 per cent. of the Central customs duty being on industrial materials and articles consumed in urban areas falls on the middle and upper classes. These classes also bear a substantial portion of the Central excise duty (as the duty on fine and

superfine cloth, tyres, motor spirit, etc.) as the States Sales Tax (which generally excludes necessities or taxes them at a very low rate, the incidence being the highest on business transactions). The Planning Commission notes that—

“Another 17 per cent. (of the total tax revenue) is accounted for by import duties, a considerable part of which is derived from taxation of commodities like motor vehicle, motor spirit and oils, high-quality tobacco, silk and silk manufactures, liquors and wines, etc. which affect but a relatively small section of the population. A large proportion of the excise duties on tobacco and cloth, which yield about 8 per cent. of the total tax revenue also probably paid by the limited number of consumers who use better varieties”.*

- (c) That on the whole the middle and upper classes are loaded with direct and indirect taxes equal to approximately 70 to 75 per cent. of the total Central and States tax revenues.
- (d) That the share of the tax burden borne by the middle and upper classes residing in rural areas is relatively much less than of those residing in urban areas because they are practically exempt from income-tax and the large

* The First Five Year Plan, Ch. III, Para. 11.

* The First Five Year Plan, Ch. III, Para. 11.

revenue has remained almost static in a time of revolutionary change.

- (e) That the lower income groups who constitute the large majority of the population contribute less than 25 to 30 per cent. of the total Central and State revenues.
- (f) That the urban lower income classes mostly consisting of industrial labour and artisans enjoying relatively high wages and large incomes per family through multiple earning have almost completely escaped the increased tax burden.
- (g) That the rural and lower income classes which have received large benefit from Government spending have assumed but a small part of the sharp increase in the burden of Central and State taxation. Referring in particular to the impact of taxation on the wealthy classes, the Planning Commission comments—
- “If as much as one-third or more of total tax revenue is derived from certain limited strata of society it implies that the burden of taxation spread over the rest of the community is lighter and that relatively small increases in the rates of taxation on the latter will help to add significantly to the total tax revenue”.*
- (h) That the major part of the fivefold increase in Central taxation and threefold increase in States taxation over the last decade has fallen principally on the urban middle and upper

class. The Planning Commission therefore emphasises that—

- “Unless fiscal policy and the machinery of taxation are assimilated so as to obtain a significantly wider coverage, the tendency will be not only for tax revenues to fall as a proportion of further additions to national income but also to make the sharing of the burden of development increasingly inequitors”.*
- (i) That, in particular, the middle and lower middle class constituting the backbone of the nation has been almost crushed between the two millstones of an inordinately high cost of living and a relatively equally heavy burden of direct and indirect taxation.

13. 5. *Distribution of Tax Burden among Different States.*—The maldistribution of the burden of taxation between rural and urban areas is apparent from the preceding paragraphs. It follows as a corollary that the tax burden has fallen most heavily on States which are more industrialised than on those which are more rural in character. Bombay and West Bengal are examples of States which have been overcharged, while States like U. P., Bihar, Orissa and others which have benefited much from increased Government expenditure have contributed relatively little in the form of additional revenue. The tax revenues of various States for 1950-51 to 1952-53 appear in Table No. 13. V. It shows that Bombay and West Bengal have the highest per capita tax among Part A States, Bihar and Orissa being at the other end of the scale carrying less than a two-fifth charge.

* The First Five Year Plan, Ch. III, Para. 11.

* The First Five Year Plan, Ch. III, Para. 17.

TABLE NO. 13. V.

State	Population in Crores	Total Tax Revenue* in Crores of Rs.		Per Capita Tax Revenue* in Rs.		Per Capita Revenue** in Rs.		Average 1937-38 to 1946-47
		1950-51	1951-52	1950-51	1951-52	1950-51	1951-52	
PART A—								
Assam . . .	.90	5.07	5.78	5.6	6.4	11.0	12.5	4.3
Bihar . . .	4.02	15.73	14.58	3.9	3.6	7.2	7.0	2.5
Bombay . . .	3.60	35.89	33.66	10.0	9.4	16.8	16.8	10.7
Madhya Pradesh . . .	2.12	10.72	11.81	5.0	5.6	9.1	10.8	4.3
Madras . . .	5.70	35.89	38.33	6.3	6.7	10.2	10.5	5.7
Orissa . . .	1.47	5.09	5.48	3.5	3.8	7.1	7.9	3.0
Punjab . . .	1.26	7.24	8.10	5.8	6.4	13.4	14.1	6.9
Uttar Pradesh . . .	6.32	27.02	27.31	4.3	4.3	8.2	8.6	3.7
West Bengal . . .	2.48	21.66	23.29	8.7	9.4	13.8	15.6	3.9
PART B—								
Hyderabad . . .	1.87	19.14	20.52	10.2	11.0	14.0	15.6	
Madhya Bharat . . .	.80	6.78	7.08	8.5	8.8	13.0	14.2	
Mysore . . .	.91	5.90	6.46	6.5	7.1	15.8	15.6	
Pepsu . . .	.35	3.73	4.29	10.7	12.3	16.1	17.0	
Rajasthan . . .	1.53	11.08	11.04	7.2	7.2	9.5	10.2	
Saurashtra . . .	.41	3.54	2.91	8.6	7.1	19.0	18.3	
Travancore-Cochin . . .	.93	7.58	8.70	8.2	9.4	15.0	19.2	
Total . . .	34.67	222.06	229.34	6.4	6.6			

* Excluding Income-tax.

** Excluding Transfers from Revenue Reserve Funds.

13. 6. *Signs of Maldistribution of Tax Burden among States.*—The per capita tax receipts of various States under main heads of revenue for 1950-51 and 1951-52 are recorded in Table No. 13 VI (Page 330). The Table shows that while older taxes like land revenue and excise, particularly the latter, still contribute to the high per capita tax of some Part B States like Hyderabad, they have been foregone on ideological ground in some Part A States which have substituted instead such taxes as entertainment duties, motor vehicles taxes, urban immovable property tax and others. As a result, the tax incidence in these States has been shifted to the urban middle and upper class population. This is evident from Table No. 13. III. The comparative rates of taxation in relation to the field of taxation as a whole have moved in the same direction. It is this sector of the industrialized States which has paid a good proportion of the import and Central excise duties and contributed almost entirely to the large collections of income-tax by the Central Government. The collections of income-tax from Bom-

(Source.—Report of the Finance Commission, 1952, Ch. III, Para. 41, pp. 58-59, and Appendix IX, Tables 1 and 6, pp. 160 and 172-73.)

bay, Bengal, Madras and other States are set out in Table No. 13. VII. As the Finance Commission (1952) acknowledges—

“Between them, the two States of Bombay and West Bengal account for nearly three-quarters of the collections of income-tax in the country: of these collections again, about three-quarters are made within the cities of Bombay and Calcutta”.*

But as indicated in Table No. 13. VIII (page 331), the share of income-tax coming back to these States from the Centre out of the distributable pool has been relatively low. The cumulative effect of these development has been to pile up taxes in one direction. In the event, the tax incidence has become unevenly distributed and the industrially advanced States have been heavily over-burdened.

* Report of the Finance Commission, 1952, Ch. IV, Para. 23.

TABLE NO. 13. VI.

State	Per Capita States Tax Revenue in Rs.									
	Land Revenue		State Excise		Stamps		Sales Tax		Total Tax Revenue	
	1950-51	1951-52	1950-51	1951-52	1950-51	1951-52	1950-51	1951-52	1950-51	1951-52
PART A—										
Assam . . .	2.1	2.0	1.0	1.3	0.3	0.3	0.8	1.1	5.6	6.4
Bihar . . .	0.4	0.4	1.3	1.2	0.6	0.6	1.1	0.9	3.9	3.6
Bombay . . .	1.8	1.7	0.3	0.3	1.1	1.2	4.2	3.6	10.0	9.4
Madhya Pradesh .	1.8	2.1	1.1	1.2	0.5	0.5	1.2	1.2	5.1	5.6
Madras . . .	1.2	1.6	0.1	0.1	0.9	0.8	2.9	3.0	6.3	6.7
Orissa . . .	0.7	0.7	1.5	1.4	0.5	0.5	0.6	0.9	3.5	3.8
Punjab . . .	1.5	1.6	1.7	2.2	0.5	0.5	1.5	1.5	5.7	6.4
Uttar Pradesh .	1.2	1.2	1.0	1.0	0.4	0.4	0.8	0.7	4.3	4.3
West Bengal .	0.9	0.8	2.5	2.7	1.1	1.2	2.5	2.8	8.7	9.4
PART B—										
Hyderabad . .	2.4	2.6	5.2	5.1	0.3	0.4	0.4	1.0	10.2	11.0
Madhya Bharat .	3.1	3.2	2.4	2.2	0.4	0.5	0.5	0.8	8.5	8.8
Mysore . . .	1.4	1.4	2.2	2.3	0.5	0.6	1.5	1.8	6.5	7.1
Pepsu . . .	2.8	2.6	5.4	6.7	0.4	0.5	1.4	1.3	10.7	12.3
Rajasthan . .	2.8	2.1	1.6	1.9	0.3	0.3	..	..	7.2	7.2
Saurashtra . .	5.5	3.7	0.4	0.4	0.5	0.6	0.2	0.7	8.6	7.1
Travancore-Cochin	0.7	0.8	2.3	2.6	0.9	1.0	2.8	2.7	8.2	9.4
Total . . .	1.4	1.5	1.4	1.4	0.6	0.6	1.7	1.7	6.4	6.6

(Source : Report of the Finance Commission, 1952, Appendix IX, Table 6(a), pp. 174-75.)

TABLE NO. 13. VII.

Year	Taxes on Personal and Corporate Income					Taxes on Personal Income				
	Percentage Contributions of State to Total					Percentage Contribution of State to Total				
	Bombay	West Bengal	Madras	Other States	Total Crores of Rs.	Bombay	West Bengal	Madras	Other States	Total Crores of Rs.
1938-39 . . .	37	42	11	10	14	38	34	16	12	8
1939-40 . . .	40	37	11	12	17	39	33	15	13	9
1940-41 . . .	42	36	11	11	21	47	24	15	14	11
1941-42 . . .	39	39	11	11	25	42	28	16	14	13
1942-43 . . .	43	37	10	10	37	49	22	16	13	15
1943-44 . . .	45	34	10	11	56	41	25	16	18	22
1944-45 . . .	44	35	10	11	72	41	24	15	20	26
1945-46 . . .	47	35	9	9	75	49	19	14	18	27
1946-47 . . .	46	36	10	8	83	49	24	15	12	35
1948-49 . . .	49	33	10	8	131	53	23	13	11	65
1949-50 . . .	49	31	10	10	147	48	25	13	14	71

(Source : Central Board of Revenue, All-India Income-tax Revenue Statistics 1938-39 to 1949.)

TABLE NO. 13. VIII.

State	Income-tax Share in Crores of Rs.		Income-tax Share as Percentage to State Revenue		Income-tax Share as Percentage to Total States' Income-tax Share	
	1950-51	1951-52	1950-51	1951-52	Annual Average 1950-52	Fixed by the Finance Commission (1952)
PART A—						
Bombay	9.95	10.99	16.5	18.2	20.9	17.50
West Bengal	6.40	7.06	18.7	18.3	13.4	11.25
Madras	8.29	9.15	14.3	15.3	17.4	15.25
Assam	1.42	1.54	14.3	13.6	2.9	2.25
Bihar	5.92	6.54	20.4	23.2	12.4	9.75
Madhya Pradesh	2.84	3.14	14.8	13.8	6.0	5.25
Orissa	1.42	1.54	13.8	13.3	3.0	3.50
Punjab	2.61	2.88	15.5	16.2	5.5	3.25
Uttar Pradesh	8.53	9.42	16.4	17.3	17.9	15.75
PART B—						
Hyderabad	—	—	—	—	—	4.50
Madhya Bharat . . . . .	.06	.08	0.6	0.5	.1	1.75
Mysore	—	—	—	—	—	2.25
Pepsu . . . . .	.16	.15	2.8	2.5	.3	0.75
Rajasthan . . . . .	.08	.12	0.6	0.8	.2	3.50
Saurashtra	—	—	—	—	—	1.00
Travancore-Cochin	—	—	—	—	—	2.50
Total	47.68	52.60	12.5	12.9	100.0	100.00

(Source.—Report of the Finance Commission, 1952, Ch. IV, Para. 30 and Appendix IX, Tables 5 (a) and 5 (b).)

Question 14.—Have shifts in the distribution of income in the community in recent years altered the relative incidence of taxation on various classes of people? If so, to what extent?

14. 1. Inflation and Shifts in Distribution of Income and Taxation.—Inflation is not so much of a forced loan free of interest as the levy of a tax. The war and post-war inflationary finance led to a drop in the purchasing power of the Rupee. If all internal prices had risen equally, the tax would have fallen upon individuals and the different classes in proportion to their incomes. But, in fact, because of the unequal rise in prices, money incomes in different sectors increased in different degrees. Those whose incomes increased the least had to bear the full force of the fall in the value of money, while the others had an advantage corresponding to the extent of the rise in their incomes. Thus inflation as a means of raising revenue had the effect of bringing about shifts in income and income groups, levying in the process not a proportional but a regressive tax. The taxing and spending policies of Government accentuated these shifts in income. Not only was there a change in the pattern of distribution but the burden of taxation on various groups was also materially altered.

14. 2. Effect on Agricultural and Non-agricultural Incomes.—Statistical data relating to distribution of income and income groups is extremely fragmentary. Income-tax statistics cover only non-agricultural incomes, as agricultural incomes are for all practical purposes not subject to income-tax. This furnishes a basis of differentiation and on a first approach, incomes may be classified into two main groups—rural and urban. The rise in incomes of these two classes may be measured by the rise in prices of the commodities of which they are the principal producers. The movement in the Index Numbers of food articles and industrial raw materials may be treated as fairly representative of the changes in prices and incomes in the agricultural sector, contributing about 50 per cent. of the national income in 1948-49 and comprising 70 per cent. of the total population of the country. The pattern of the entire rural area covering more than 60 per cent. of the national income and 80 per cent. of the total population has been dominated by these changes. Their influence is registered in the relative Index Numbers marked down in Table No. 14. I. Against them are

set the Index Numbers of Semi-manufactured Articles and Manufactured Articles as representative indices of the urban area covering approximately 40 per cent. of the national income and 20 per cent. of the total population. The rise in agricultural indices must have added substantially to agricultural incomes as a whole. Starting from the base 100 in 1939, the Index Numbers for food articles and industrial raw materials were up by 307 per cent. and 389 per cent. respectively by August, 1953. Against this, the indices for Semi-manufactured and Manufactured Articles recorded a smaller rise of 265 per cent. and 271 per cent. over the same period. Obviously, the balance swung heavily in favour of the agricultural class and the rural area as a whole.

TABLE NO. 14. I.

Year	Index Number of Wholesale Price			
	Food Articles	Industrial Raw Materials	Semi-Manufactured Articles	Manufactured Articles
1939 (Aug.)	100	100	100	100
1947	292	365	252	277
1948	374	431	317	341
1949	389	464	328	344
1950	410	503	341	348
1951	410	608	378	396
1952	360	453	347	378
1953 (Aug.)	407	489	365	371

(Source.—Monthly Abstract of Statistics, September, 1951, Table No. 70.)

14. 3. *Distribution Within the Rural Area.*—Compared with the urban area, the rural area gained considerably more through the rise in prices. Within the rural area itself, the benefit was spread over a number of groups in varying proportions. These groups are classified in Table No. 14. II. (Page 332). Broadly, farmers and agriculturists cultivating land constituted two-thirds of the rural population, the remaining one-third being equally divided between agricultural labourers and the non-

agricultural population. Their relative position may be summed up as under:

(a) Agricultural labour is widely scattered and not organised into bargaining groups. According to the 1951 census, though agricultural wages witnessed a rise over the last decade, it may be surmised that the share of agricultural labour in the total gain made by the rural sector was relative

TABLE NO. 14. II.

(Population in Millions)

Rural Population	Self-Supporting	Earning Dependents	Non-Earning Dependents	Total	Percentage to Population	
					Rural	Total
<i>Agricultural:</i>						
Cultivating Owners	44.7	21.1	97.1	162.9	56	46
	(27)	(13)	(60)	(100)		
Cultivating Non-Owners	8.3	3.9	18.0	30.2	19	9
	(27)	(13)	(60)	(100)		
Cultivating Labourers	11.0	5.1	23.6	39.7	14	11
	(28)	(13)	(69)	(100)		
Non-Cultivating Owners	1.4	.3	2.7	4.4	1	1
	(32)	(7)	(61)	(100)		
Total	65.4	30.4	141.4	237.2	81	67
	(28)	(13)	(59)	(100)		
<i>Non-Agricultural:</i>						
Production	7.4	2.4	12.9	22.7	8	7
Commerce	2.4	.5	5.5	8.4	3	2
Transport . . . . .	.5	.1	1.3	1.9	1	1
Other Services	6.7	1.8	12.0	21.4	7	6
Total	17.0	4.8	32.6	54.4	19	16
	(31)	(9)	(60)	(100)		
Total	82.4	35.2	174.0	291.6	100	83

(Source.—Census of India, 1951, Paper No. III (1953), Summary Table IV.)

less than that accruing to the group of farmers and agriculturists cultivating land.

(b) Of the non-agricultural rural population, one-fifth was occupied in commerce and transport and the remaining four-fifths equally divided between production and other services. The occupational status of the self-supporting group engaged in these activities is shown in Table No. 14. III. As according to the Table, three-fifths of the group consisted of independent workers and only two-fifths were employees, the non-agricultural rural population also probably improved its position more than proportionately in relation to the agricultural labourers.

TABLE NO. 14. III.

Status	Self-Supporting Non-agricultural Rural Population	
	In Crores	Percentage to Total
Employers . . . . .	.3	2
Employees	6.1	36
Independent Workers	10.1	59
Unclassified . . . . .	.5	3
Total	17.0	100

(Source.—Census of India, 1951, Paper No. 3 (1953), Summary Table V.)

(c) From the point of view of the income-effect, therefore, it may be gathered that while the rural sector as a whole moved up in the scale, the shift of income was in favour of farmers and agriculturists cultivating land, the non-agricultural rural population and agricultural labour taking the second and third place in the order of priority.

(d) Whereas the income-effect worked in one direction in the rural sector, the taxation effect worked in the other. This heightened the disparity in relation to the urban sector. As appears from Table No. 6. II, the proportion of indirect taxes (which are more widely distributed) fell consistently, while the percentage of direct taxes (which are entirely borne by the

urban area) to the total Central revenue doubled as compared with the pre-war year. In other words, instead of an increase in taxation in rural areas corresponding to the rise in income, there was a regressive movement.

(e) It may therefore be concluded that the farmers and agriculturists cultivating land were, as a group, the principal beneficiaries of the shift in income and that the non-agricultural rural population also gained, though perhaps not much.

14. 4. *Main Classes in the Urban Area.*—The urban sector, which covered about 20 per cent. of the total population and 40 per cent. of the national income, may be divided into three main classes:

- Industrial labour.
- Middle class, mostly with fixed incomes.
- Upper class.

How these classes were affected by taxation and what was the change in their position may be examined in some detail.

14. 5. *Gains made by Industrial Labour.*—The court taken by employment and earnings of industrial labour is reflected in Table No. 14. IV. The Table indicates that

TABLE NO. 14. IV.

Year	Number of Workers Employed in Lakhs	Per Capita Income Rs. 1939—100	Total Wage Bill Crores of Rs.	1939—100
1939	17.51	287.5	50.34	100
1940	18.44	307.7	56.74	112
1941	21.56	324.5	70.00	139
1942	22.82	—	—	—
1943	24.36	525.0	127.89	254
1944	25.22	586.5	147.91	293
1945	26.42	595.8	157.41	312
1946	23.14	619.4	143.32	284
1947	22.74	737.0	167.59	332
1948	23.60	883.0	208.38	413
1949	24.33	985.9	233.30	463
1950	25.04	964.3	241.46	479
1951	25.36	1,035.4	262.57	521

(Source.—Monthly Abstract of Statistics, September 1953, Tables 6 and 73.)

wages of industrial labour increased more than three and a half times from 1939 to 1951 in spite of "industrial productivity in India having gone down substantially since 1939—by about 20 to 30 per cent.—in certain lines".* During the same period, the number of workers employed increased by more than 7½ lakhs, from 17½ lakhs to over 25½ lakhs. The aggregate income of industrial labour as a group accordingly multiplied almost five times over. The enlargement in the scope of employment provided opportunities for gainful occupation to more than one member of the working-class family. The income of the family as a unit, therefore, recorded a larger rise than that appearing from the per capita increase in wages. In addition, there were other advantages, such as cheap food grains, medical benefits and social amenities. On the other hand, the expenses of the group did not witness a proportionate increase. Their expenditure on housing, education and such other overheads remained almost static at the old levels. At the same time, in the matter of taxation, the group continued to remain outside the orbit of direct taxes and the fall in the relative proportion of indirect taxes to direct taxes helped to lighten the burden of taxation. The shift in income and the incidence of taxation, therefore, both moved strongly in favour of the industrial labour group.

14. 6. Position of Middle and Upper Classes.—The middle and upper classes mostly residing in urban areas

* The First Five Year Plan, Ch. XXIX, Para. 43.

See also Report of the Fiscal Commission (1951-52), Ch. XVIII, Para. 240.

were the two small groups which carried the entire burden of direct taxes on income and profits. Published income-tax statistics throw some light on the distribution of income within these classes and on the incidence of taxation. The total number and amount of personal incomes charged to tax and the total tax levied thereon from 1940-41 to 1949-50 appear in Table No. 14. V. The Table shows that over the decade the total number of income-tax assesseees increased from about 3 3/5 lakhs to 4 2/5 lakhs, that is, by about 4/5 lakh, against an increase of approximately 7 lakhs in the industrial labour class. Over the same period, the gross income of the group comprising income-tax assesseees increased from Rs. 167 crores to Rs. 417 crores, that is, by 250 crores, while the net income increased from Rs. 153 crores to Rs. 335 crores, that is, by Rs. 182 crores. In other words, the gross income of the group as a whole increased by about two and a half times and the net income by about two and a quarter times compared with the four fold increase in the earnings of the industrial labour class from Rs. 57 crores to Rs. 223 crores. This is apparent from Table No. 14. VI. The Table also shows that, whereas the annual per capita earnings of the labour class were up by about three and a quarter times, the net annual per capita income of the group of income-tax assesseees increased by a little over three-quarter as much. This 78 per cent. increase from 1940 to 1949 may be set against the rise of 173 per cent. in the Cost of Living Index (Bombay) and of 223 per cent. in the General Index. The conclusion is that the middle and upper classes, particularly those with fixed incomes, were adversely affected.

TABLE NO. 14. V.

Year	Number of Assesseees Lakhs	Gross Income Crores of Rs.	Tax paid (Income-tax, Super-tax, E.P.T. and B.P.T.) Crores of Rs.	Net Income Crores of Rs.	Percentage of Net Income to Gross Income Per cent	Per Capita	
						Tax Paid Rs.	Net Income Rs.
1940-41	3.59	166.80	14.24	152.56	92	396	4,250
1941-42	3.98	183.64	18.48	165.16	90	464	3,041
1942-43	3.79	199.55	23.09	176.46	88	609	4,655
1943-44	3.83	271.70	42.12	229.58	85	1,100	5,994
1944-45	4.17	304.14	57.83	246.31	81	1,387	5,907
1945-46	4.22	326.55	47.31	279.24	86	1,121	6,617
1946-47	4.44	341.79	55.16	286.63	84	1,242	6,456
1948-49	4.65	415.33	83.33	332.00	80	1,792	7,138
1949-50	4.42	417.40	82.74	334.66	80	1,872	7,571

(Source.—Central Board of Revenue, All-India Income-tax Revenue Statistics, 1940-41 to 1949-50, and Reserve Bank of India Reports on Currency and Finance, 1942-43 to 1950-51.)

TABLE NO. 14. VI.

(1939—100)

Year	Number in Lakhs		Per Capita Income		Total Income of		
	Factory Workers	Income-tax Assesseees	Factory Workers	Income-tax Assesseees (Net)	Factory Workers	Income-tax Assesseees Gross	Net
1940	18.44	3.59	100	100	100	100	100
1941	21.56	3.98	105	72	123	110	108
1942	22.82	3.79	..	110	..	119	115
1943	24.36	3.82	170	141	225	162	150
1944	25.22	4.17	190	139	260	182	161
1945	26.42	4.22	193	156	277	195	183
1946	23.14	4.44	201	151	252	204	188
1947	22.74	4.08	239	..	290	..	..
1948	23.60	4.64	286	168	367	248	218
1949	24.33	4.42	320	178	411	250	219

(Based on Tables Nos. 14. IV and 14. V.)

14. 7. *Classification according to Functions and Income.*—For a proper appreciation of the income, distribution and taxation effects, incomes subject to income-tax may be vertically classified into five functional categories and horizontally classified into two principal income groups with division into sub-groups as under:

Vertical Functional Classification	Horizontal Income Classification
1. Salaries	1. Middle Class— (a) Lower—Income upto Rs. 5,000.
2. Profits and Gains of Business or Profession	(b) Middle—Income Rs. 5,000—10,000.
3. Dividends	(c) Upper—Income Rs. 10,000—25,000.
4. Interest on Government Securities.	2. Upper Class— (a) Income Rs. 25,000—1,00,000.
5. Rent	(b) Income above Rs. 1,00,000.

14. 8. *Functional Groups—Income Distribution.*—The changes in the distribution of income relatively as between various functional groups over the decade 1940 to 1949 are reflected in Table No. 14. VII. The Table shows that, though the number of salary earners as a percentage of the total number of taxpayers rose from 20 to 27 per cent. between 1940 and 1949, their share of the total taxable income actually diminished from 30 per cent. to about 22 per cent. Rent receivers were also worse off. Though their number declined from 19.5 per cent. to 16.4 per cent. of the total number of assessees, their share in the total taxable income declined much more, dropping from 6 per cent. of the total to 4 per cent. On the other hand, interest and dividend earners relatively gained a little. The number of interest earners shrank from 9.5 per cent. to 6.5 per cent. of the total and the decline in their share of the taxable income was from 3 per cent. to about 2.5 per cent. of the total. The percentage of dividend receivers to the total remained more or less at 11 per cent. and so did their income at about 7 per cent. of the total. Comparatively, the main advantage accrued to profit earners. Their number rose slightly from 27 per cent. of the total to 29 per cent. but their share of the total taxable income moved up by 11 per cent. from 49 per cent. to more than 60 per cent. Obviously, profit earners were right at the top and their relative gain in income was at the expense of salary earners and rent receivers.

TABLE NO. 14. VII.

Functional Group		Group as Percentage to Total									
		Salary		Profits		Dividend		Interest		Rent	
Year		No. of Assessecs	Income	No. of Assessecs	Income	No. of Assessecs	Income	No. of Assessecs	Income	No. of Assessecs	Income
1940-41	. .	20.6	30.4	27.4	48.9	10.5	5.5	9.5	3.1	19.6	6.3
1941-42	. .	19.5	26.5	26.1	52.6	11.6	5.9	10.0	5.0	19.4	5.9
1942-43	. .	17.3	21.6	29.3	59.9	11.9	6.2	8.8	3.1	20.5	5.2
1943-44	. .	18.5	19.0	32.9	65.2	9.5	5.8	7.7	2.0	20.9	4.3
1944-45	. .	25.3	20.6	29.5	64.3	9.4	6.4	7.2	2.1	19.1	3.6
1945-46	. .	24.9	22.1	29.5	62.1	9.6	6.2	7.2	2.3	18.9	3.7
1946-47	. .	25.0	24.1	29.8	58.9	9.6	6.1	6.8	2.7	18.2	3.8
1948-49	. .	26.9	22.3	28.7	53.9	10.9	7.1	6.7	2.5	16.4	3.7
1949-50	. .	24.1	19.2	30.6	62.9	11.4	6.6	6.6	1.9	16.4	3.6

(Source : Central Board of Revenue, All-India Income-tax Revenue Statistics, 1940-41 to 1948-49.)

14. 9. *Functional Groups—Incidence of Tax.*—The variations in the incidence of tax on the different functional groups during the period 1940 to 1949 are recorded in Table No. 14. VIII. In 1949, salary earners paid 10.7 per cent. of their gross income as tax, whereas rent receivers paid double as much at 21 per cent., profit earners even more at 30 per cent. the investment group of interest

and dividend recipients being the most heavily taxed at 45 per cent. and 37 per cent. respectively. In the case of all groups, there was a sharp increase in the burden of taxation from 1939 to 1949—by 50 per cent. in the case of salary, profits and dividend recipients and by 150 per cent. to 200 per cent. in the case of other groups. The net per capita income of the various groups reflected this

TABLE NO. 14. VIII.

Group	Year	Salary		Profits		Dividend		Interest		Rent	
		Tax as Percentage of Gross Income	Per Capita Net Income	Tax as Percentage of Gross Income	Per Capita Net Income	Tax as Percentage of Gross Income	Per Capita Net Income	Tax as Percentage of Gross Income	Per Capita Net Income	Tax as Percentage of Gross Income	Per Capita Net Income
			Rs.		Rs.		Rs.		Rs.		Rs.
	1940-41	5.7	5,054	14.0	5,588	18.3	1,566	16.0	981	8.9	1,062
	1941-42	6.2	4,767	14.7	6,452	16.9	6,452	16.8	920	9.1	1,030
	1942-43	6.9	4,774	16.5	7,007	18.9	1,726	17.9	1,188	9.9	931
	1943-44	7.0	4,653	17.4	7,986	20.9	2,367	18.8	1,031	10.3	891
	1944-45	6.8	4,259	19.1	9,807	19.5	3,038	22.8	1,238	11.7	931
	1945-46	7.1	4,935	19.5	10,140	23.0	2,978	21.2	1,527	11.4	1,032
	1946-47	6.6	5,081	23.4	8,510	25.5	2,682	29.0	1,563	16.3	990
	1948-49	9.5	5,092	28.7	9,968	35.1	2,865	34.1	1,648	20.6	1,207
	1949-50	10.7	5,274	30.1	10,680	37.0	2,729	45.4	1,149	21.1	1,284

(Source.—Central Board of Revenue, All-India Income-tax Revenue Statistics, 1940-41 to 1948-49.)

heavy charge. Against the general rise in prices of approximately 300 per cent. over the decade, the per capita income of salary earners after payment of tax was barely maintained at the old level, that of rent receivers improved a little by about 15 per cent. in later years and the rise was grossly incommensurate even in the case of other groups whose net income went up by about 75 per cent. towards the close of the period. Salary earners, as a class, were the worst hit among all. Evidently, not only was there a shift in net income in favour of rural areas and against the urban areas as well as against the fixed income earning groups, but the relative incidence of taxation was also against the urban sector generally and the fixed income earning groups in particular.

14. 10. *Income Groups—Distribution of Income.*—The foregoing trends repeat themselves on an analysis of the statistical data relating to the horizontal income groups

consisting of the middle and upper classes with their subsidiaries. As appears from Table No. 14. IX, while the number of lower middle class assessee declined from 70 per cent. to 55 per cent. of the total number from 1940 to 1949, their income expressed as a percentage of the total income dropped by twice as much from 34 per cent. to 20 per cent. The middle and upper middle classes also suffered. Over the decade, the number of assessee in these two groups as a percentage to the total increased by about 50 per cent. from 17 and 9 to 26 and 15 respectively, but their shares as a percentage to the total income remained more or less constant at 20 and 23 respectively. Only the two groups of the upper class fully maintained their position. Their number and income expressed as a percentage to the total doubled from 1940 to 1949. In this rearrangement of the pattern of incomes distribution the middle classes were obviously the losers.

TABLE NO. 14. IX.

		Group as Percentage to Total									
Income Group Rs.		Under Rs. 5,000		5,000—10,000		10,000—25,000		25,000—1,00,000		Over Rs. 1,00,000	
Year		No. of Assessee	Income	No. of Assessee	Income	No. of Assessee	Income	No. of Assessee	Income	No. of Assessee	Income
1940-41	.	71.9	34.4	17.0	21.2	8.8	23.0	2.2	14.4	.2	7.1
1941-42	.	72.2	31.3	16.3	20.1	8.9	24.1	2.3	16.5	.2	8.0
1942-43	.	68.6	27.7	17.7	19.6	10.5	25.3	3.0	18.8	.2	8.6
1943-44	.	64.7	25.0	19.2	18.9	12.1	25.9	3.8	21.1	.3	9.1
1944-45	.	63.3	23.4	19.8	19.1	12.7	26.3	3.9	21.4	.3	9.9
1945-46	.	59.2	22.3	22.5	19.5	13.9	26.4	4.1	21.0	.4	10.8
1946-47	.	60.1	23.0	22.6	20.7	12.7	24.7	4.1	21.3	.6	10.4
1947-48	.	58.9	22.4	23.3	20.7	13.6	26.0	3.9	20.1	.4	10.9
1948-49	.	56.2	19.7	24.3	19.2	13.9	23.4	5.1	23.7	.5	14.2
1949-50	.	52.7	18.7	26.2	19.3	14.8	23.4	5.8	25.5	.5	13.1

(Source.—Central Board of Revenue, All-India Income-tax Revenue Statistics, 1940-41 to 1948-49.)

TABLE NO. 14. X.

Income Group Rs.		Under Rs. 5,000		5,000—10,000		10,000—25,000		25,000—1,00,000		Over Rs. 1,00,000	
Year		Tax as Percentage of Gross Income	Per Capita Net Income	Tax as Percentage of Gross Income	Per Capita Net Income	Tax as Percentage of Gross Income	Per Capita Net Income	Tax as Percentage of Gross Income	Per Capita Net Income	Tax as Percentage of Gross Income	Per Capita Net Income
			Rs.		Rs.		Rs.		Rs.		Rs.
1940-41	.	2.2	2,173	4.5	5,544	8.4	11,032	16.9	25,779	35.1	1,31,325
1941-42	.	1.9	1,959	4.8	5,427	8.5	11,427	16.7	26,618	35.1	1,25,264
1942-43	.	2.4	2,077	4.6	5,564	8.6	11,635	16.8	27,287	33.4	1,26,044
1943-44	.	2.4	2,676	4.6	6,658	8.6	13,899	16.8	33,224	35.2	1,49,906
1944-45	.	2.4	2,631	4.6	6,701	8.7	13,819	17.1	33,395	35.7	1,38,936
1945-46	.	2.4	2,848	4.5	6,399	8.4	13,497	16.8	33,217	36.3	1,44,887
1946-47	.	2.6	2,874	5.2	6,684	10.0	13,466	19.6	32,495	41.9	84,929
1947-48	.	2.8	2,884	5.8	6,510	11.2	13,222	22.3	31,548	7.1	1,80,380
1948-49	.	3.1	3,037	6.0	6,647	12.6	13,068	23.5	31,723	55.5	1,12,082
1949-50	.	2.9	3,245	5.8	6,552	13.0	13,035	25.9	39,563	58.7	97,234

(Source.—Central Board of Revenue, All-India Income-tax Revenue Statistics, 1940-41 to 1948-49.)

14. 11. *Income Groups—Incidence of Taxation.*—The impact of taxes (other than E. P. T. and B. P. T.) on the middle and upper classes is recorded in Table No. 14. X. As is seen from the Table, the incidence in the case of the upper middle class and upper class rose by about 50 per cent. to 75 per cent. over the decade 1940 to 1949. The percentage of income paid as taxes increased but little, from 2 to 3 per cent. and 4 to 6 per cent. of the gross income respectively, in the case of the lower and middle class groups, whereas in respect of the three higher

groups the percentages increased over the decade from 8, 17 and 35 to 13, 26 and 59 respectively. The full impact of the shift in income and taxation was reflected in the insignificant rise in the per capita net income of every group. Against the general rise in prices approximating 300 per cent., the per capita income of the lower middle class rose by about 50 per cent. of the intermediate three classes by about 18 per cent. the net per capita of the top group actually falling off by about 15 to 25 per cent. in later years. The fact therefore stands confirmed that the

shift in income and in the incidence of taxation was to the advantage of the rural and against the urban sector and that the middle classes and the fixed income earning functional groups were in particular the major sufferers over the decade stretching from 1940-1949.

14. 12. *Conclusions.*—The conclusions may be briefly stated. The shift in income during the decade 1940-49 was distinctly in favour of the rural population and the urban industrial labour class at the cost of the other urban groups, particularly the middle class. At the same time, the burden of taxation falling on the rural population was diminished and that imposed on the urban sector correspondingly increased, the brunt being borne by the upper and upper middle classes. The consequences have been inescapable. The high level of direct taxes, especially the steeply progressive super tax, and the incidence of such indirect taxes as customs and excise duties, licensing fees and heavy State and municipal taxes have reduced the incentive and damaged the capacity of those income groups which used to save and invest in productive enterprise. Curiously, investors as a class have been the most heavily taxed. The resulting gap in capital formation has not been filled up by the rural population and the urban industrial labour class in whose favour there has been a shift of income. Potential savings that would have been otherwise available to the community for investment have been dissipated. The scattered distribution amongst a large mass not enjoying a high standard of living, without any well-developed saving habit and spread over a wide area, has rendered it difficult to canalise the flow of additional income into fruitful channels. On the other hand, the capacity of the middle class to save and invest has been crippled. While the terms of trade have moved by far to the advantage of industrial labour and the farmers and agriculturists paying few taxes and subject to a fixed land revenue whose incidence has diminished in real terms, the purchasing power of the middle classes, particularly of those with fixed incomes, has been reduced to a half or third, depending on the bracket, upper, middle or low, to which they belong. In fact, the price mechanism has imposed on them a burden exceeding that of any direct or indirect tax. On them has fallen the main stress and strain of the shifting burden of inflation. The imposition of taxes much higher than on those who have benefited from the shifts in income has heightened the inequity. The middle classes have thus fallen victim to the political pressure for equilibration of current money incomes. Their savings have tended to disappear and their stability as an economic group has been seriously impaired. The likely consequences have not passed unobserved. As Prof. Kenne H. Parsons has warned in his Report* to the Planning Commission, unless productivity is improved, any further movement in present day India for elimination of inequalities through shifts in income will only end in "equality of poverty".

Question 15.—Do you think that the cost of compliance with tax regulations adds materially to the burden of taxation? If so, in respect of what taxes? Please give details.

15. 1. *Increase in Cost of Compliance with Tax Regulations.*—The cost of compliance with tax regulations has increased appreciably in recent years, and if the volume of complaints against Government Departments and the number of appeals preferred are any indication, it seems more than likely that the cost of compliance has added materially to the burden of taxation.

15. 2. *Growing Cost of Tax Collection.*—The large and growing cost of tax collection is in some ways a reciprocal reflection of the rising cost of tax compliance. As Table No. 15. I shows, the direct demands on revenue have mounted up from year to year. Though a substan-

TABLE NO. 15. I.

(Crores of Rs.)

Year	Direct Demands on Revenue	
	Centre	Part A States
1939-40	3.86	9.33
1943-44	6.09	13.68
1944-45	8.31	17.40
1945-46	9.67	19.09
1946-47	10.37	17.03
1948-49	8.62	19.68
1949-50	13.90	24.01
1950-51	12.50	24.30
1951-52	16.23	26.23
1952-53	14.63	29.66

(Source.—Reserve Bank of India Reports on Currency and Finance, 1940-41 to 1952-53.)

* Parsons, Report to the Planning Commission on Land Reforms.

tial justification for this increase may be found in the expansion of services, the expenditure should also be judged in relation to the facts of daily experience. The multiplicity of staff and the need to justify excessive expenditure have led to unnecessary duplication, proliferation of returns and paper work, causing confusion and delay in disposal and contributing to the costs of compliance. In fact, the Select Committee on the Estimates* has commented adversely on the bureaucratic habits acquired during the war. The maintenance of detailed records, filling up of forms and submission of returns inflict a hardship on small establishments. This is particularly true of Sales tax, Income-tax and the specific excise duties levied on some industries. The burden of taxation has therefore materially increased especially in the case of small traders and businessmen.

15. 3. *Costs of Complicated Legislation.*—Tax law have also become increasingly complicated. There has been a tendency to legislate even when the gains in revenue are disproportionately small, irrespective of the cost in terms of man-hours to the tax-payer and Government itself. The intricate nature of tax regulations combined with onerous penalties on the tax payer whenever there is an infraction have added to the burden of responsibility and to the costs of observance. The uncertainty in respect of legal liability, the voluminous quantity of new law enacted, the variations made therein time and again and the expansion of executive authority because of the growing practice of governance by delegated legislation, have imposed a heavy burden on the tax-payer in addition to the tax itself. The operation of Sales Tax in various States is an instance in point. The obligation to keep records classified in numerous ways, differing requirements and doubtful instructions entail labour and expense. Further, specialists and professional advisers have to be employed for understanding the precise implications of the complicated laws and for appearing on behalf of the tax-payers before the tax authorities. The rise of a new profession of Income-tax, Sales Tax and other "experts" is a symptom that the costs of compliance with tax regulations must have substantially increased.

15. 4. *Enlarged Powers of Tax Collectors an Element of Cost.*—The vastly enlarged powers of tax collectors is another element in the cost of compliance. Power corrupts, absolute power corrupts absolutely. Lack of consideration, arbitrary and high-handed demands and peremptory orders subject the tax-payer to harassment, interfere with his normal business and at times put him into serious difficulties. Appeals become necessary, litigation has to be entered into for obtaining relief and costs of compliance are correspondingly increased. When the appeal is limited to the Department itself, the burden of the tax is further magnified.

15. 5. *Costs of Compliance and the Income-tax Department.*—What is true of all Departments is perhaps more true of the Income-tax Department. An extremely complicated law, the wide powers vested in Income-tax Officers, harassment and "official inquisition" of assesses, and delay, indifference and lack of consideration for the convenience of tax-payers are some of the common complaints and they combine together to add in a large measure to the costs of tax compliance. Witness the following from the Report of the Income-tax Investigation Commission (1948-49):

"The Income-tax Officer and the system of which he is the product are held, in these replies, responsible for driving the taxpayer first to non-cooperation then to hostility and thirdly to evasion. Incivility, incompetence, extortion and lethargy are some of the accusations made against the Income-tax Officers while the administration as a whole is blamed as wooden, ill-managed, unimaginative and unjust . . . Even after making due allowance for exaggeration of language; it is evident from the replies that a strong feeling of distrust and discontent exists in the public mind against the administration of income-tax in this country".**

Further on, the Commission makes the following comment on the attitude of the Department and the Income tax Officer:

"He is judged efficient not by the knowledge he shows or the manner in which he deals with the assesses, but on the increase he makes in the demand of tax. His approach to assessment is thus not that of a fair judge but of a partisan collector of revenue . . . We would suggest that an Income-tax Officer should be judged not on the number of heavy assessments he makes but on the number of unsuccessful appeals against his assessments; on the knowledge and understanding he shows and not on the pitch to which he raises his assessments; on the speed at

* U. N. Public Finance Surveys—India (1951), Ch. V p. 54.

** Report of the Income-tax Investigation Commission 1948-49, Section IV, Para. 357.

his collections and not on the size of his paper demands".*

here is little doubt that the manner in which the taxing departments are administered adds to the burden of compliance with tax regulations. The arrears of assessments and refund applications cause much hardship. Such arrears pending on the 31st of July, 1948, exceeded three lakhs, as shown in Table No. 15. II (Page 337). The delay in dealing with refund applications is particularly reprehensible as it accentuates the objectionable effects of the system of taxation at source under which assessee

TABLE NO. 15. II.

Year	Number pending on 31st July, 1948.	
	Assessments in Arrears	Refund Applications
1947-48	1,54,344	17,310
1946-47	77,121	2,113
1945-46	36,923	1,086
1944-45 and earlier	17,886	695
TOTAL	2,86,274	21,204

Source.—Report of the Income-tax Investigation Commission, 1948-49, Section I, Para. 13.)

are penalised. In the words of the Income-tax Investigation Commission—

"The hardship resulting from the deduction to persons who are exempt or entitled to considerable relief is clearly a serious one especially where dividends or interest on securities are the main sources of income".**

As in connection with tax deducted at source, so with taxes payable in advance, the assessee is subjected to a great deal of hardship. Arbitrary assessments and demands, refusal to grant time for payment and the long delay and expenses involved in appeal are some of the usual grievances. References to the High Court are not infrequent and the Courts have had occasion to pass strictures on the administration. On this point, the Income-tax Investigation Commission observes as under:

"As late as 1943, the Chief Justice of the Bombay High Court made strong remarks about the way in which the rights of appeal provided by law (as it then stood) to the Assistant Commissioner and Commissioner "proved a farce" in practice.....We gather

* Report of the Income-tax Investigation Commission, 1948-49, Section IV, Para. 445.

** Report of the Income-tax Investigation Commission, Section IV, Para. 275.

that the Tribunal often finds itself embarrassed by the attitude of the officers of the Department in their very method of approach to the problems that arise before them."*

15. 6. Conclusion.—The foregoing facts are difficult to ignore. They are relevant because the way in which taxing departments function and the manner of their administration admittedly influence the costs of compliance with tax regulations. As matters stand today, these costs are unnecessarily increased, and they thus add not a little to the actual burden of taxation.

Question 16.—Do the benefits accruing from public expenditure have a bearing on a consideration of the burden of taxation? If so, how would you take this into account in considering the burden of Indian taxation?

16. 1. Taxation and Public Expenditure.—A reference has been made in Para. 4. 3 above to Sir Josiah Stamp's view that the limit of taxable capacity depends in part upon what purpose taxation is to be used for. As the Indian Taxation Enquiry Committee (1924-25) observes—

"It is essential for a determination of the economic effects of taxation to know how and where taxes are spent. To take an instance, if a State replaced a private system of education by a State system and levied a tax to pay for it, which was less than the sum paid to the private teachers, there would be an apparent addition to the tax burden, but actually a reduction in the expenditure of the taxpayer."**

The point has been amplified in some detail in the answer to Question No. 5, where it has been noted that the extent of spending on defence, general administration and social services by various countries is an important determinant of the proper proportion of tax revenues to the national income of a country. A well contrived system of expenditure may adjust individual incomes more closely to individual or family needs through, for example, education and health service, old age and widows' pensions, sickness, maternity and unemployment benefits, etc., which would provide a set-off to a heavier burden of taxation. Accordingly, when assessing the burden of taxation in India, it is necessary to analyse the content of public expenditure under two broad categories, namely—

- that incurred for preserving the social life of the community as, for example, on defence, security, law and order;
- that incurred for improving the quality of that social life by making it more worth living as, for example, through expenditure on social purposes like education, health, old age, unemployment, etc. and for promoting the development of trade, commerce and industry of the country.

16. 2. Central and State Expenditure Classified and Compared.—The revenue expenditure of Central and State Governments under main heads is classified in Tables Nos. 16. I. and 16. II (Pages 337-38):

* Report of the Income-tax Investigation Commission, 1948-49, Section II, Para. 20.

** Report of the Indian Taxation Enquiry Committee, 1924-25, Ch. XIV, Para. 478.

TABLE NO. 16. I.

(Crores of Rs.)

Year	Main Heads of Central Govt. Revenue Expenditure					Total Central Govt. Revenue Expenditure
	Defence	Social Security*	Direct Demands on Revenue	Social Services**	Civil Works	
1938-39	46.2	10.0	4.2	1.0	2.5	85.1
1940-41	73.6	11.4	3.8	1.0	3.0	114.2
1942-43	214.6	11.6	5.1	5.1	3.1	288.9
1944-45	395.5	16.2	8.3	7.9	..	496.3
1946-47	207.4	25.8	10.4	13.6	5.6	343.5
1948-49	146.1	18.2	8.6	17.3	6.6	320.9
1949-50	148.9	21.6	13.9	17.7	6.5	317.1
1950-51	164.1	25.4	12.5	23.4	10.4	351.4
1951-52	171.0	28.8	16.2	24.9	11.4	387.3
1952-53	192.7	29.9	31.1	26.3	14.8	422.4

* Includes General Administration, Police, etc.

** Includes Scientific Depts., Education, Medical, Public Health, Industries, etc.

(Source.—Budgets of the Central Government, 1939-40 to 1953-54.)

TABLE NO. 16. II.

(Cro

Main Heads of Part A States Revenue Expenditure

Year	Social Security*	Direct Demands on Revenue	Social Services**	Irrigation
1938-39	26.6	8.8	20.9	5.4
1940-41	29.2	9.7	24.3	7.9
1942-43	34.3	11.6	27.7	8.3
1944-45	44.2	17.4	38.2	10.8
1946-47	61.9	17.0	54.4	8.8
1948-49	73.4	19.7	68.9	9.7
1949-50	89.6	24.0	87.1	10.9
1950-51	90.0	24.3	90.1	12.5
1951-52	91.3	26.2	99.1	14.1
1952-53	92.3	29.7	100.9	13.7

* Includes General Administration, Police, etc.

** Includes Scientific Depts., Education, Medical, Public Health, Industries, etc.

(Source.—Reserve Bank of India Reports on Currency and Finance, 1939-40 to 1952-53.)

A consolidated statement showing the Central and States expenditure under three principal heads as a percentage of the total Central and States expenditure appears in Table No. 16. III. The 50 per cent. expenditure on defence and social security is a predominant feature of these Tables. No less significant is the large and growing cost of tax collection and general administration. Accusations of waste, inefficiency, graft and corruption made against public departments tend to show that the expenditure incurred is excessive in relation to the results obtained. Making allowances for increased activities, it is the opinion of the Select Committee on the Estimates* that the outsize expansion of services seems to be a consequence of the bureaucratic habits acquired during the war. In the U. S. A., the Hoover Commission recommended to Government that the service establishment could be reduced without loss of efficiency as there was too much duplication of work. Dean Paul H. Appleby speaks as follows of a Flow Chart showing the secretariat method of dealing with correspondence in the Government of West Bengal:

"The chart showed from 30 to 42 different handlings of a letter when the letter was given consideration only with a single department of."

It is not believed that the West Bengal system is notably different from the system in vogue in the Centre."

There is little doubt that the administrative system should be simplified, rival administrative departments be abolished or amalgamated and public departments should be re-equipped and reorganised on business lines to promote efficiency and economy. The heavy charge for defence and general administration directly competes with spending on economic advancement. The 16 to 17 per cent. expenditure on essential social services and development is in strong contrast to what is spent in the U. S. A. Witness, for example, the meagre combined State Government outlay amounting to 1.5 per cent. on education and 3.7 per cent. on health in 1952-53 as compared in Table No. 5. IV. The disparity requires comment.

16. 3. Influence of Public Expenditure on Taxation.—Public expenditure may be expected to benefit to a particular group of people.

* U. N. Public Finance Surveys—India (1951), Ch. V, p. 54.

* Appleby, Public Administration in India, a Survey (1953), Sec. VIII, p. 57.

TABLE NO. 16. III.

Main Heads of Revenue Expenditure as Percentage to Total Central and Part A States Revenue Expenditure

Year	Defence		Administration			Social Services and Development		
	Central	States	Central	States	Total	Central	States	Total
1938-39	27.0	10.8	20.7	31.5	0.2	15.4	15.6	
1940-41	35.2	7.3	18.6	25.9	0.2	16.2	16.4	
1942-43	52.7	4.1	11.3	15.4	0.2	11.3	11.5	
1944-45	56.5	3.5	8.8	12.3	0.1	8.8	8.9	
1952-53	92.3	29.7	100.9	13.7	14.1			

benefit to the community as a whole, or partly of special and partly of general benefit. This broad fact must be kept in view when imposing taxes or granting relief so that the burden of taxation is not unfairly distributed as between different groups. The main question, however, is what are the benefits accruing out of current Central and State revenue expenditure. The per capita Central and State expenditure on selected services during 1950-52 is set out in Table No. 16. IV. The small amount spent per capita on social services, particularly in relation to what is spent in other countries,* must cause dismay.

TABLE NO. 16. IV.

Selected Services	Per Capita Central and States Expenditure in Rs.	
	1950-51	1951-52
<i>Social Security—</i>		
Defence	4.7	5.2
Police	1.6	1.7
General—Administration . .	1.2	1.3
Others	0.5	0.6
Total Rs.	8.0	8.8
<i>Social Services—</i>		
Education	1.8	1.9
Medical and Public Health .	0.8	0.9
Others	1.0	1.0
Total Rs.	3.6	3.8

(Source.—Report of the Finance Commission (1952), Ch. III, pp. 52-53 and 56-57.)

It is not that there is no spending. But mere spending is not welfare. As recently pointed out in the U. N. seminar lectures on the formulation of development plans, an item of expenditure should be approved not only because it is good in itself, but also because, when compared with all the other objects of expenditure, it promises to yield the best results as measured by the benefits derived from it. This principle of "opportunity cost" must be recognised and implemented when a country so poor as India proposes to do so much with such few resources. Unfortunately, discounting ideosyncracies and delusions, there is little sign of welfare in the country outside the capital expenditure on planning and development. The amount spent out of revenue on nation-building activities like social services, education, labour, civil works, etc. has no doubt increased from Rs. 30 crores in 1938-39 to Rs. 155 crores in 1952-53 at the Centre and in the States combined. However, its chief visible sign has been an unending spate of legislation and the tangible benefit accruing therefrom has been far from commensurate. Much of the expenditure has been unproductive, being incurred on salaries for an inflated bureaucratic staff. The point is dealt with in Para. 19.2 below. The results have therefore been disproportionately small in

* See Para. 5.3.

relation to the quantum of the expenditure. The capital spending on development has been indeed not negligible, nor can its effects be ignored. But it has been mostly at the cost of the private sector, which is being denuded of its savings. The diversion has been to the benefit of areas and groups which contribute but little to the common pool of taxation. They should be therefore put under levy through adequate increases in land revenue and suitable indirect taxes, so that the balance may be restored and relief given to the hard pressed middle and upper classes. These classes have been badly hurt by the present high levels of taxation and appropriate redistribution of taxes according to benefits received from public expenditure would revive their capacity to save, invest and produce, thereby helping capital formation and enlarging the national income of the country.

Question 17.—Do you think that the tax burden weighs particularly heavily on any individual industry or occupation? If so, please furnish the Commission with the evidence on which you rely.

17. 1. *Tax Burden on Industries.*—It appears that the burden of taxation has been unduly heavy in the case of some industries as compared with others. For example, it is estimated that the textile industry has been subjected to a number of imports, which, apart from income-tax, constitute 20 per cent. of the total cost of production. Similarly, for the sugar industry, it is estimated that excise duty, cane cess and other taxes constitute 33 per cent. of the ex-factory price of Rs. 75 per bag. The steep rise in prices of the products of various industries reflect in varying measure the shift of these heavy taxes on to the consumers. Though it is neither an industry nor an occupation, it may be said that consumers as a class have been the most heavily taxed. Scarcity and prevalence of sellers' markets for many years have enabled producers to pass on the major part of the burden of taxes levied on them to the consumer in the shape of high prices. Signs of a change are impending. Sellers' markets are gradually being replaced by buyers' markets, consumer resistance to high prices is increasing and the stock position is becoming difficult. In the case of some industries it seems that either production and output will have to be reduced, causing unemployment and general loss of welfare, or taxes will have to be reduced as they have tended to cost inflation by entering directly into the price and cost of production. This is true not only of the cotton and sugar industries, but also of others, for example those dependent on export markets, such as jute and coal. In other words, taxes have tended to contribute directly to inflation. The general level of taxes must therefore be brought down.

17. 2. *Tax Burden on Occupations.*—As with industries, so also for occupations, it appears that the burden of tax has weighed very heavily in not a few cases. For example, as has been pointed out in Paras. 14.8 and 14.9, landlords as a class have been discriminated against. Rents have been rigidly controlled while costs of repair and construction have gone up and at the same time heavy Government taxes, such as the Urban Immoveable Property Tax in Bombay, have been imposed and local rates and taxes have been sharply increased. Other occupations also have been adversely affected. In particular, the profession of stockbrokers has been severely penalised. How their position has deteriorated in comparison with other occupations and what have been the contributory causes may be briefly explained.

17. 3. *Tax Burden on the Stock Broking Profession.*—The change in the relative position of the stockbroking profession and other occupations is set out in Table No. 17. I. It is evident from the Table which records the

TABLE NO. 17. I.

Trade Classification	Net Per Capita Income (1941-42-100)							
	1941-42	1942-43	1943-44	1944-45	1945-46	1946-47	1948-49	1949-50
Mines, Quarries, etc.	100	97	86	104	102	88	65	63
Textile Manufacture	100	113	270	475	452	320	274	329
Metal and Metal Goods Manufacture.	100	85	68	48	45	98	78	81
Food Manufacture	100	134	149	226	209	219	171	185
Chemicals, Leather, Paper, etc., manufacture.	100	125	153	183	232	168	197	163
Building and Miscellaneous goods manufacture.	100	93	172	158	151	201	211	178
Distribution and communications.	100	105	177	144	138	116	142	150
Professions	100	93	111	145	200	142	190	166
Finance (other than Stock Brokers).	100	113	165	184	236	248	274	277
Stock and Share Brokers and Jobbers.	100	113	94	110	122	98	139	122

(Source.—Central Board of Revenue, All-India Income-tax Revenue Statistics, 1941-42 to 1949-50.)

percentage variations in the per capita net income over the period 1941-42 to 1949-50 that in comparison with most other trades the position of stock brokers has been worse in every year and that their net money income has increased very little—by about 20 per cent. only against the steep rise in prices of about 400 per cent. The decline in stock market activity has contributed to the decline in stock broking incomes; but over and above that, the profession of stock brokers—as of other brokers in forward markets—has been singled out in Bombay for further heavy taxation in the form of extortionately high stamp duties levied by the State Government on contracts relating to the purchase and sale of shares and securities. The nature and incidence of the tax have been analysed in some detail in answer to Questions 162 and 163 in Part V of the Questionnaire. It is enough to state here that the stamp duty has operated as a tax on the very method and machinery of business and has had to be paid irrespective of whether profits are earned or losses incurred. Its effect has been to drain away the life-blood of the profession. Table No. 17. II shows the total amount of Stamp Duty paid under this head by members of the Stock Exchange in Bombay and the annual per capita stamp duty charge as compared with the net income of all stock brokers and jobbers assessed to income-tax in the entire Bombay State and the per capita and total amount of income-tax and super-tax paid by them during the years for which statistics are available. It is clear from the Table that about 25 to 30 per cent. of the net assessable income of members is annually taken away from them in the form of an usurious stamp duty. The discrimination against the Stock Exchange is too obvious to call for any laboured argument. Income-tax, super-tax and corporation tax have to be paid only if the business has been lucrative and profits have been earned. They therefore bear some relation to equity and capacity. Contrariwise, the Stamp Duty has to be paid irrespective of whether trade has been good or bad and the earnings on the credit or debit side. A monthly tax of approximately Rs. 500 to Rs. 600 per member, no matter whether there is a profit or whether there is a loss, offends against all recognised canons of taxation. The figure has only to be stated to demonstrate how the Stamp Duty has passed beyond the limits of endurance. A tax—if it can be so called—of this nature and magnitude has imposed an unconscionable burden on stock brokers and seriously weakened their strength and capacity. In spite of frequent warnings and repeated appeals, the burden of the Stamp Duty has not been reduced. Inevitably, as Table No. 17. II shows, the point of diminishing returns has been reached and the annual yield is now less than half of what it used to be. In addition to the Stamp Duty, the burden of income-tax on the stockbroking profession has recently been increased indirectly by disallowing set-off of speculation losses except against speculation gains, even though speculation gains continue to be included in the income of the assessee chargeable to tax. The implications of this extraordinary restriction, for which there appears to be no parallel in any other part of the world, are discussed at some length in the answer to Question No. 74 in Part II of the Questionnaire. It is enough to state here that the duress implicit in disallowing speculation losses will destroy speculation gains which form the substance of trade and livelihood and are the source from which the tax revenue itself is derived. The effect of such coercive measures and excessively heavy

stamp duty imposts can only be to disrupt the efficient functioning of forward markets by slowly garroting *bona fide* trade and to increase the burden of tax on the stockbrokers' profession beyond their capacity to bear. It is possible to kill the goose that lays the golden egg. In the interests of the revenue itself, as much as in the interests of the profession of stockbrokers the unreasonable restraints must be forthwith removed and the crushing burden of stamp duty drastically reduced.

Question 18.—What role would you assign to taxation vis-a-vis various types of borrowing in finding the additional resources required for the development programme of the country?

18. 1. Resources Required for the Development Programme.—The development programme of the country contemplates a high rate of capital investment. The additional resources required can only come from internal savings, either private or public, or from external loans, on a sufficiently large scale. If internal private savings or external loans are not easily forthcoming the gap arising from excess investment has to be adjusted by budget surpluses, failing which inflation through deficit financing becomes inevitable. As the Planning Commission observes, if rapid capital formation is the object in view, it will be necessary—

“To impose on the community a high rate of savings through taxation, loans, price inflation or by any other means and to utilise the resources thus made available for a sharp increase in the rate of capital formation.”*

But whatever the channel employed—borrowing, taxation or deficit financing—, what is ultimately involved in all these cases is curtailment of current consumption so that more may be available out of production for capital investment. This fact must be remembered.

18. 2. Development Programme should be Financed through Borrowing.—Ordinarily, straightforward taxation is preferable to deadweight public debts which leave a trail of interest and capital repayment charges and throw an increasing direct and indirect burden on the community. But public debts employed for creating public assets and producing an income sufficient to take care of the service charges impose no such burden. They are comparable to the debenture capital of a company and the subscribers to the loans to debenture holders. The interest on the loans is met out of income accruing to the public authority from the ownership of property or conduct of enterprises. It is sometimes suggested that, even in such cases, more reliance should be placed on taxes and less on loans, so that when development schemes mature there is no mortgage on the resulting benefit. Even now, new capital expenditure is being financed by taxation to a larger extent than is generally realised. But when such expenditure is on the scale and of the magnitude involved in the development programme, the heavy taxation necessary would soon reach the limit when the incentives to production and saving are destroyed and taxes enter into the cost of production. That would then tend to generate cost inflation with the result that much more would be lost in the private sector than gained in the public sector. The total of budget surpluses in this country amounting to approximately Rs. 300 crores between 1948 and 1952

* The First Five Year Plan, Ch. I, Para. 24.

TABLE NO. 17. II.

The Stock Exchange, Bombay							Bombay State—Brokers and Jobbers Assessed to Income-Tax			
Year	No. of Active Members	Stamp Duty Paid		No. of Assesseees	Net Income Free of Income-tax and Super-tax in Lakhs of Rs.	Income-tax and Super-tax Paid Total in Lakhs of Rs.	Super-tax Per Assessee			
		Total in Lakhs of Rs.	Per Active Member							
			Rs.				Rs.			
1940-41	. . .	248	4.17	1,618						
1941-42	. . .	241	4.11	1,704	730*	68.82	15.94	2,180		
1947-48	. . .	321	24.21	7,541	1,172	100.57	36.34	3,100		
1948-49	. . .	326	16.36	5,017	1,033	113.13	59.22	5,733		
1949-50	. . .	326	21.52	6,602	1,005	100.31	39.86	3,966		
1950-51	. . .	326	21.14	6,485						
1951-52	. . .	318	50.52	6,452						
1952-53	. . .	294	9.05	3,077						

(Source : Central Board of Revenue, All-India Income-tax Revenue Statistics, 1941-42 to 1949-50, and Clearing House of the Stock Exchange, Bombay.)

*Estimated. Total Number for All-India 1,153.

had exactly these effects. It therefore seems desirable that the development programme should be financed through borrowing rather than taxation so that members of the community remain free to subscribe to loans according to their incomes, capacity, inclinations and circumstances. The success of the State loans this year, particularly in the districts as in Madras, indicates that there is good scope for public borrowing. A vigorous small savings campaign is therefore likely to yield encouraging results.

18. 3. Compulsory Saving.—When public borrowing through voluntary loans falls short of requirements, the alternative of compulsory savings or forced loans is often canvassed. A forced loan must be compulsorily subscribed by different individuals in the same manner as a tax. In the case of middle and upper classes, such a provision would either operate as a tax and therefore as a strong disincentive, or if it does not, even then it would prove of little avail as compulsory loans would probably replace rather than add to voluntary savings. But for the large mass of people comprising industrial labour and other groups, whose incomes have increased but whom politically it seems inexpedient to tax, compulsory loans would enforce a cut in consumption and may well at the same time inculcate the saving habit.

18. 4. External Borrowing.—In an underdeveloped country with a small per capita income and with living standards on the border of subsistence, a cut in consumption on a sufficiently large scale to finance development expenditure may be difficult to achieve. Colin Clark has suggested empirically that an increase in the ratio of Government expenditure to national income beyond a critical percentage limit tends to generate inflation. In advanced countries where standards of living are high and the margin of saving substantially broad, the ratios are correspondingly high. For example, in the U. K. the percentage has been as high as 40. In 1947, the contribution of budget surpluses towards capital formation was negligible but in 1948 it accounted for nearly one-third of the total. The trend has now changed,* for even in the U. K. a stage was quickly reached when the powerful disincentives to work and save induced businessmen to play golf on week days. In an underdeveloped country like India, the critical percentage of net expenditure to the national income is much lower, as there is little to spare above the margin of subsistence. Any attempt at reduction in consumption through taxation or internal borrowing meets with resistance and results in inflation. In such circumstances, external borrowing may legitimately be resorted to for financing development projects.

18. 5. Distinction between Internal and External Loans.—External loans must be distinguished from internal borrowing. Internal loans imply a transfer of wealth within the community and their burden arises from a redistribution of income between different groups within the country itself. On the other hand, external loans impose on posterity the burden of interest charges and repayment of capital which operate as a debit for the community as a whole. They not only disturb subsequent budgets but also become an important factor in the international balance of payments. But internal loans are not always a practicable alternative to external loans, as, for example, when the spending has to be done abroad and the necessary foreign exchange resources are not immediately available. In such cases, external assistance is indispensable. As the Planning Commission puts it—

“To a certain extent, the volume of domestic resources available for investment can be augmented through appropriate fiscal and economic policy, through compulsory savings, and through drawing on unutilised manpower. There will, however, still remain certain shortages which would tend to restrain the whole force of development, and it is in meeting these that external resources can be of help.”**

Apart from free external aid, such resources can also be drawn from specialised agencies like the World Bank which have for their object the rapid development of the natural resources of underdeveloped countries when the task is too big for their nationals to perform unaided. When borrowing yields little and taxation has passed to the stage of diminishing returns, external borrowing either through a recourse to these agencies or otherwise is inevitable in finding the resources required for the development programme of the country.

18. 6. The Importance of Internal and External Borrowing.—The development Plan is committed to a certain level of expenditure and the volume of expenditure has to be covered by taxation or by borrowing at home or abroad, failing which there must be a resort to deficit financing. Taxation seems to have reached the point of saturation. The Planning Commission, in July

1953, has expressed its fears at “the inability of the private sector to maintain the rate of investment according to the plan and programme”. But taxation has starved the private sector by diverting resources to the public sector, emasculated the capital market by penalising thrift and dissipating savings and has tended to become an inflationary factor by entering into the cost of production. Almost as a direct result, internal borrowing has failed to achieve a satisfactory response and external borrowing has been inadequate to the needs. For the present, the gap is being closed by deficit financing. But if the rate of development expenditure must be maintained—being conceived as essential if political democracy is to survive in this country—, the remedy seems to lie in reducing and redistributing the burden of taxation and in promoting capital investment through private savings supported by influx of external capital in adequate volume. Even so, the ultimate question will remain whether the rate of development contemplated in the Plan can be achieved within the framework of a free economy and political democracy without recourse to totalitarian methods of coercion for cutting down consumption to the bone so as to provide the surplus required for capital investment.

Question 19.—In maximising the resources required for the financing of development, what degree of importance would you assign to: (a) economy and rationalisation in expenditure, (b) prevention of tax avoidance and tax evasion, (c) higher rates of existing taxes, (d) fresh taxes, (e) development of non-tax revenues?

19. 1. Public Expenditure—Need of Economy and Rationalisation.—From the point of view of both, husbanding the resources of the country and preventing uneconomic waste which is a dead loss to the community, it is necessary that public expenditure should be rationalised and reduced. Some indication of the extraordinary growth of public expenditure and its maldistribution under different heads has been given in Para. 16. 2 supported by Tables Nos. 16. I and 16. II. The relationship of public expenditure to the per capita national income has been referred to in Para. 5. 3 and the disproportionately large amount of expenditure devoted to defence and police services has been pointed out in Paras. 5. 3 and 16. 2 and illustrated by Tables Nos. 5. V and 16. IV. The increasingly higher cost of revenue collection as shown in Table No. 15. I has been commented on in Para. 15. 2 and the continuous rise in the charges for general administration has been noted in Para. 16. 2 and illustrated by Tables Nos. 16. I and 16. II. The relatively small percentage of expenditure on social and economic services has been mentioned in Paras. 5. 3, 16. 2 and 16. 3 and its comparative insignificance revealed in Tables Nos. 5. IV and 16. II to 16. IV. Herein is a *prima facie* case for economy and rationalisation.

19. 2. Bloated Staff Expenditure.—The expenditure of public authorities in 1948-49 classified under three broad heads appears in Table No. 19. I. The Table shows that Civil Administration salaries and wages amount to Rs. 342 crores or more than one-fourth of the total expenditure. Defence wages and salaries constitute another Rs. 117 crores and public enterprises Rs. 221 crores, so that on the whole Rs. 680 crores, that is, more than 50 per cent. of the total expenditure of Rs. 1,214 crores is incurred on wages and salaries. Of the balance, stores, stationery and services absorb Rs. 360 crores or more than a fourth of the total. As the Central and State Governments are the principal contributors to the total

TABLE NO. 19. I.
(Crores of Rs.)

Expenditure by Public Authorities on	Wages and Salaries	Stores, Services etc.	Other Payments	Total
Administration—				
Current .	281	70		351
Capital .	61	20		81
Defence (Current)	117	162		279
Subsidies and Transfers (Current).	..		60	60
Public Enterprises—				
Current .	157	52	107	316
Capital .	64	66	7	127
TOTAL .	680	360	174	1,214

(Source.—First Report of the National Income Committee (April 1951), Ch. VI, Table 12.)

* Reserve Bank of India Report on Currency and Finance, 1952-53, pp. 10-11.

** The First Five Year Plan, Ch. I, Para. 45.

expenditure of public authorities, a major portion of the rise of Rs. 340 crores at the Centre and of Rs. 255 crores in the States between 1938-39 and 1952-53 recorded in Tables Nos. 16. I and 16. II may be put down under the head wages and salaries. While a substantial portion of this enormous increase may be accounted for by the rise in wages, salaries and other allowances, say, by 100 per cent., it is obvious that an extraordinary increase in the strength of the staff, of the order of 100 per cent., has taken place after 1938-39. Confirmation of this fact is to be found in Table No. 19. II (Page 342) recording the increase in the number of persons employed by the Central Government since 1950. The sharp rise in the number of administrative and clerical staff compared with the skilled, semi-skilled and unskilled personnel is specially noticeable and it offers a clear indication of the growth of bureaucratic habits adversely commented on by the Select Committee on the Estimates.* The 14 per cent. increase in the executive staff and 18 per cent. increase in the clerical staff in three and a half years

* See Paras. 15. 1 and 16. 2.

following upon a decade of continuous expansion must cause concern. The change in political status and enlargement of the functions of Government may justify a reasonable increase but clearly it must be in some relation to the previous strength and current state activities. A large part of the expenditure on salaries is, in the main, unproductive. In its First Report, the National Income Committee states as under:

"In the Government sector, the output of government administrative services is by definition equal to the cost of these services. It is interesting to note that the cost of government administration in this sense (that is, the net output per engaged person in this sector) is practically double the average output in the country."

It follows that the number of men on the pay-roll of Government and the size of the wages and salary bill must be brought under immediate control.

* First Report of the National Income Committee (April 1951), Ch. V, Para. 5. 8.

TABLE NO. 19. II.

Central Government Employees*	Number in Thousands				Number (1950=100)			
	1950	1951	1952	1953 (July)	1950	1951	1952	1953 (July)
Administrative and Executive.	51.9	54.8	58.6	59.0	100	106	113	114
Clerical	132.0	142.9	150.9	156.0	100	108	114	118
Skilled and Semi-Skilled**.	148.0	145.3	145.4	152.0	100	98	98	103
Unskilled	245.5	247.7	260.6	252.7	100	101	106	103
TOTAL	577.4	590.7	615.5	619.7	100	102	107	107

*Excluding Employees of Railways and Indian Embassies and Missions abroad.

**All skilled and semi-skilled operatives not included.

(Source.—Monthly Abstract of Statistics, September 1953, Table 5.)

19. 3. *Top Priority for Economy and Rationalisation.*—Apart from salaries, the expenditure on stores, stationery and other supplies is also an important item. The large increases under this head require careful investigation. The top-heavy capital spending on development schemes and other Government undertakings far in excess of estimates has been referred to in Para. 7. 6. The insufficient planning of State projects has been criticised by the Select Committee on the Estimates.* The necessity of a strict scrutiny of expenditure in all directions is obvious. Rationalisation and economy should not be abandoned merely on the ground that defence expenditure cannot be curtailed and that civil expenditure is diffused and difficult to curb. This helpless attitude towards Government expenditure involving in the aggregate more than Rs. 800 crores must be discouraged. The dissipation of funds on infructuous purposes involves heavy taxation of the public, implying a reduction in the quantum of goods and services that would be otherwise available for the benefit of tax-payers. It is not enough that budgets are balanced at progressively higher levels of expenditure through back-breaking taxation. What is urgent and essential is stringent control of expenditure and a ruthless drive for economy and rationalisation without which no relief can be obtained. These, therefore, must take the top priority.

19. 4. *Little Scope for Higher Rates of Existing Taxes.*—Enough has been said in the foregoing paragraphs to show that, except in the case of land revenue, agricultural income-tax and similar other imposts, there is no scope for higher rates of existing taxes. On the contrary, what is presently necessary is a scaling down and redistribution of the tax burden among different sections of the community. In this respect, the point of diminishing returns seems to have been passed. Accordingly, a reduction in existing rates and proper re-adjustment between direct and indirect taxes are of great importance and should be given a high priority. Ultimately, such lower taxes, by stimulating production, saving and investment, will benefit the exchequer by fetching a better yield.

19. 5. *Inter-relationship between High Rates and Tax Avoidance and Evasion.*—The questions of prevention of tax avoidance and tax evasion and of higher rates of taxes are inter-related. When the tax-payer is left with a reasonable and appropriate share of his earnings, he

* See First Report of the Select Committee on the Estimates.

does not entertain a sense of grievance and the temptation to avoid and evade taxes also diminishes. As the Taxation Committee of New Zealand points out—

"Legal avoidance takes many forms and is encouraged by high taxation. Tax laws are complex and in some directions inequitable As the taxing authority insists on payment according to the law, the tax-payer cannot be condemned for following the form of the law to avoid liability for taxation. Tax avoidance does not occur only with large tax-payers. The spirit of avoidance is evident in those who will not work longer, or try harder, because too much goes in taxes."

It is no less a fact that only high rates are worth the risks and hazards of penalties and blackmail which follow upon manipulation and fabrication of records incidental to tax evasion. For example, evasion was rampant in Italy when the income and super taxes were high. In the end, income-tax had to be reduced from 18 per cent. to 13 per cent. on incomes exceeding Rs. 7,500 and the super-tax rates slashed from 12½ to 3½ per cent. on incomes of Rs. 7,500 from 35½ to 8 per cent. on incomes of Rs. 37,500 and from 73½ to 22½ per cent. on incomes of Rs. 3½ lakhs to promote a more normal state of affairs. For the same reasons, the French Budget for 1952 granted an amnesty to enable tax-dodgers who had not declared their hoards of currency or gold to do so without stating their origin.* In this connection, the Income-tax Investigation Commission makes the following observation:

"It has been strongly pressed on us that the present rates of income-tax and super-tax are so high as to defeat their purpose by discouraging enterprise and by increasing the temptation to conceal business income. It has been added that there is more likelihood of a larger tax income being realised at a moderate rate of tax than at a higher rate. We do not belittle the force of this argument..... So far as the temptation to evade is attributable to high rates of taxation, it must be met in the same manner as every other attempt to evade tax."**

It is only proper that, while taxes should be scaled down to reduce the temptation to evade, those guilty of evasion should be ruthlessly punished.

19. 6. *The Evil of Tax Evasion.*—The tax-dodger is an unmitigated nuisance and a menace to society. The

* See Reserve Bank of India Report on Currency and Finance, 1951-52, Para. 5, p. 17.

** Report of the Income-tax Investigation Commission (1948-49), Part I, Sec. II, Para. 15.

loss of revenue resulting from his anti-social activities increases the burden thrown on the honest tax-payer. On this point, the Planning Commission comments as under:

"Apart from the question of legal coverage, there is the question of actual coverage which is a function of the administrative arrangements for securing that those liable to tax do in fact pay. In India it would appear that there are considerable leakages on this account..... The reports of the Income-tax Investigation Commission show that such evasion takes place in the middle as well as higher income ranges. The fact that the corporate form of organisation is confined to a limited sector of business renders the problem of checking evasion difficult, particularly in regard to trading operations..... If such evasions could be stopped, it might make a considerable addition to the receipts under direct taxation."*

Apart from tax evasion through concealment and manipulation, there is internal evidence in the Central Board of Revenue statistics from which it appears that a considerable number of incomes chargeable to tax escapes assessment altogether. This can be gathered from Table No 19. III. Treating the 1940-41 figures as 100, the Table records the changes in the number of non-salary earners as distinguished from salary earners for various income-groups during the period 1940-41 to 1949-50. Two facts emerge. First, throughout the decade, the movement in the series for salary earners—in whose case there can be practically no tax evasion—broadly corresponds for all the five income-groups from year to year. Secondly, whilst this also holds true of the other series representing the number of non-salary earners in respect of all

the four income-groups above Rs. 5,000, the group of non-salary earners under Rs. 5,000 is the only one which shows a movement in the contrary direction. Actually, over the decade, while there is a consistent rise resulting in an increase in the number of assesseees from 100 to 300 per cent. in all non-salary income-groups above Rs. 5,000, the group under Rs. 5,000 is the only one in which the number falls off and that by more than 25 per cent. This striking downward trend in the non-salary group earning under Rs. 5,000, contrary to the main trend in almost all the other classes in both the salary and non-salary groups, goes to indicate that a large number of non-salary assesseees in the lower income brackets are escaping assessment to income-tax. The problem of such tax evasion is not peculiar to India. For example, the Board of Inland Revenue in the U. K. estimated in its Ninety-fourth Report that some 40,000 cases had escaped assessment and also recorded that in some 8,000 cases for the years 1948-51 a total charge of more than £21 Millions or about Rs. 28½ crores was raised inclusive of penalties. In India, the sum of approximately Rs. 100 crores* so far uncovered indicates the magnitude of the problem. Prevention of tax avoidance and evasion can increase the yield substantially, and though it cannot be treated as a source of revenue, there are distinct possibilities under this head which should be fully exploited. But its importance will wane and a substantial portion of the tax presently being avoided or evaded will naturally flow into the exchequer leading to large abundance if the general level of existing taxes is scaled down accompanied by a more equitable redistribution amongst the different sections of the community.

* See Reserve Bank of India Report on Currency and Finance, 1951-52, Para. 51, p. 74.

* The First Five Year Plan, Ch. III, Para. 13.

TABLE NO. 19. III.

Income Group Rs.	Number of Non-corporate Assesseees (1940-41=100)									
	Under Rs. 5,000		5000—10,000		10,000—25,000		25,000—1,00,000		Over Rs. 10,0000	
Year	Salary	Non-Salary	Salary	Non-Salary	Salary	Non-Salary	Salary	Non-Salary	Salary	Non-Salary
1940-41	100	100	100	100	100	100	100	100	100	100
1941-42	113	111	103	109	107	115	115	126	163	126
1942-43	103	99	101	115	110	134	131	155	278	143
1943-44	83	101	74	147	70	194	59	241	45	198
1944-45	153	81	86	165	95	211	78	266	58	258
1945-46	134	81	125	174	129	219	103	259	45	290
1946-47	135	90	79	163	151	195	102	290	65	453
1948-49	155	79	183	186	157	233	120	387	50	434
1949-50	132	73	158	209	120	260	106	433	45	432

(Source : Central Board of Revenue, All-India Revenue Statistics, 1940-41 to 1949-50)

19. 7. *Limited Scope for Fresh Taxes.*—It has been suggested that not only should existing taxation be reduced but it should also be redistributed to secure a better balance between direct and indirect taxes as well as between the agricultural and industrial labour population on the one hand and the urban middle and upper classes on the other. Accordingly, those fresh taxes which, through substitution or reduction of existing imposts, help to bring about a proper redistribution may be considered desirable. Among these may be included the salt tax, revenue from excise duties on liquor, revision of land revenue and development of agricultural income-tax on a national basis, which would to some extent relieve the urban population of the inordinately heavy burden of income and profit taxes and at the same time yield a sizeable revenue.

19. 8. *Doubtful Contributions of Non-tax Revenues.*—Development of non-tax revenues is more an expression of hope than a fact of experience. The answers to Questions Nos. 7, 10 and 11 above deal with what would be the contributions to the exchequer under this head and the doubt there appearing may be restated without loss of conviction.

Question 20.—Under the Five-Year Plan the public sector is expected to undertake a larger investment; an important place is also assigned to the private sector in the development programme. How would you devise a tax policy suitable to the development programme of the country in both sectors?

20. 1. *Investment A Function of National Income and Consumption.*—Apart from external loans and free aid,

the total investment (planned and unplanned) of a country is equivalent to the surplus of national income over consumption expenditure. The means whereby the private sector can take a share of this surplus is through private savings, whereas the public sector can do so in more than one way—by borrowing private savings, or by revenue surpluses through taxation, or by deficit financing which is a concealed form of taxation. Obviously, the public sector can, through heavy taxation or deficit financing, starve the private sector by appropriating a larger proportion of the surplus. But, in the main part, it cannot increase the surplus itself, which is a function of the national income and consumption expenditure. In fact, heavy taxation and inflation may ultimately work in the other direction through their adverse reactions on the incentive and ability to produce and to save.

20. 2. *Importance of High Rate of Savings.*—The Five Year Plan estimates that the total planned and unplanned investment during the five-year period will be about Rs. 3,500 crores*. Of this, the investment in the public sector is expected to be about Rs. 1,700 crores or roughly 50 per cent. of the total. The balance investment of about Rs. 1,800 crores in the private sector is made up of about Rs. 550 crores or 16 per cent. of the total as planned investment in large scale industry, the residue of about Rs. 1,250 crores or 34 per cent. of the total representing unplanned investment in private small scale industry, agriculture, housing, etc. The responsibility for industrial expansion and development rests in the main on the private sector and in the allocation of resources the

* The First Five Year Plan, Ch. III, Para. 42.

provision made for investment in the private sector appears to be inadequate in the light of its needs and requirements. Even on the basis of this under-estimate, the problem, as the Planning Commission recognises, is not one of diverting investment from the private to the public sector but of increasing the total.* In other words, the emphasis in a right taxation policy should fall, not on transfer of resources from the private to the public sector, but on stepping up the rate of savings on which (apart from external resources) the development or investment expenditure in the last analysis depends. Savings can increase by increasing production and reducing consumption. It follows that the principal object of the policy should be to tax consumption and not to overburden the productive mechanism or those groups and classes which save and invest.

20. 3. *Effect of Taxes on Savings.*—It is generally recognised that a large proportion of high incomes is saved and ploughed back for further expansion. Accordingly, direct taxation of such incomes impinges more on savings and production than on consumption. It has been established in the foregoing paragraphs that a disproportionately heavy burden of the total taxation falls on the small middle and upper income groups. This fact has been noted by the Planning Commission which has observed that—

“If as much as one-third or more of total tax revenue is derived from certain limited strata of society it implies that the burden of taxation spread over the rest of the community is correspondingly lighter and that relatively small increases in the rates of taxation on the latter will help to add significantly to total tax revenue.”†

The current direct taxes on income and profits and the other imposts are high not only relatively but also in terms of the burden they impose. They act as a powerful disincentive to saving and investment and merely help to drain off resources from the private to the public sector. The total investment is in no way increased. Instead, they tend to generate cost inflation and thereby reduce the percentage of total private and public investment in relation to the national income. The conclusion appears to be that not only should the emphasis shift from direct to indirect taxation through a switch over to more appropriate indirect taxes but also that the absolute burden of taxes should be drastically reduced, partly by scaling down the rates now in force and partly by grant of suitable concessions and reliefs with a view to encouraging savings and promoting capital formation.

20. 4. *Revision of Tax Policy Essential.*—A revision of the tax policy on the lines indicated will also conform to equity. The Five Year Plan envisages investment of almost Rs. 900 crores, equal to about 44 per cent. of the total capital outlay of about Rs. 2,000 crores, in agriculture, multi-purpose schemes and irrigation, power and community development projects. Accordingly, the productivity and taxable capacity of the rural population may be expected to improve and a portion of these gains may legitimately be drawn into the public exchequer by suitable modification in taxes. As the Planning Commission concludes—

“Unless fiscal policy is reorientated so as to obtain a significantly wider coverage, the tendency will be not only for tax revenues to fall as a proportion of further additions to national income, but to make the sharing of the burden of development increasingly iniquitous.”‡

Question 21.—What part can tax policy play in stimulating capital formation in the private sector consistently with the needs of the public sector?

21. 1. *Taxation affects Capital Formation at all Stages.*—The Fiscal Commission (1948-50) has described capital formation as a long process consisting of three principal stages. The first stage is concerned with creation of savings, that is, a surplus resulting from an excess of income over expenditure. The sources of these savings are individuals, business or trading houses and public authorities. In the second stage, savings are mobilised for investment in trade, industry or agriculture, and in the third stage, the funds so invested are converted into capital goods when “capital formation” in the strict sense of the term takes place. Among the problems that arise at the different stages of capital formation, the Commission particularly mentions those relating to the will to save and the capacity to save in the different sectors of the economy; the leakages from the stream of savings because of the conditions and circumstances in which savings are not made available for conversion into investible funds; and the factors of depreciation and replacement allowances and the level of earnings which govern the utilization of investible funds for the acquisition of capital goods. Tax considerations enter at each one of these stages and it is obvious that tax policy can

play an important part in restricting or stimulating capital formation.

21. 2. *Effect of Taxation.*—The high level of taxes on income and profits has an immediate impact on the will and the capacity to save. The element of steep progression and the cumulative burden of taxes on a comparatively small group of people have seriously affected the incentive and scope for thrift and saving. Similarly, the conversion of savings into investment has been impeded by high taxation on incentives to invest. Risk or venture capital prepared to carry the risks inherent in promoting new enterprise in an under-developed economy must have its reward in the shape of higher earnings. Heavy personal and corporation taxes, which take away a substantial part of the gains accruing as a result of risk taken and pioneering work done, act as a strong deterrent to new investment and development expenditure. Tax reliefs and concessions are essential for newly established enterprises to promote flotation of new ventures. For the same reason, further progress and expansion of existing enterprises are retarded. The system of taxation has also a direct bearing on the maintenance in tact of the existing capital, which is as important as new capital formation. It would be an anomaly to allow existing capital to be depleted while new capital is being formed. The depreciation and replacement allowances rehabilitate industry by providing the replacement of productive assets at the end of their working life. It follows that tax regulations should provide a scheme of depreciation allowances properly related to current costs of replacement, without which it is not income but capital that is taxed and dissipated. Tax policy also influences the formation of capital within the industry itself by ploughing back of profits. Tax exemptions to new enterprises for a given number of years and a reduction in the corporation tax offer direct encouragement to corporate savings which are fruitfully invested in development programmes and schemes of further expansion.

21. 3. *Taxation must correspond to Optimum Rate of Capital Formation.*—Without formation of capital there can be no economic progress and the level of taxation must therefore correspond to the optimum rate of capital formation. The economic development as envisaged in the coming years is in the context of a mixed economy. Under the First Five Year Plan, the private sector is charged with most of the responsibility for the expansion and modernisation of industries and there is the additional charge that existing capital equipment must be maintained in tact through replacement and renewal. If the private sector is to discharge these duties, it must be left with sufficient resources. The tax policy must be devised accordingly. It must be remembered that it is the private sector which contributes today 91.3 per cent. of the national product, of which about 40 per cent. is from commerce, mining and industry.* If essential resources are diverted from the private to the public sector through unwise taxation, a lower rate of capital formation in the private sector will not only lead to economic stagnation but may well cause a setback through dissipation of capital which is not replaced fully or fast enough in terms of productive capacity. The present contribution of the public sector to the national product is relatively small and by how much will it increase through increments in investment currently contemplated is a question which must be considered in determining the level of taxation. The increasing expenditure on the part of the Central and State Governments, which if well-meaning is immediately non-productive, will have to be related to the broader question of capital formation and to the effects of taxation on such accumulation if economic development is to be accelerated for attaining higher standards of living.

Question 22.—(i) Is there evidence for the view that the rate of private capital formation in the community has been lower in the last few years as compared to the pre-war period? What factors, in your opinion, account for the decline?

(ii) Has there been a shift in recent years in the sources of capital formation in the private sector as between individuals, corporations and other institutions?

22. 1. *Rate of Savings and Investment.*—It has been pointed out in para. 21. 1 that capital formation is a function of savings and that in turn the rate of savings is governed by the national income and consumption expenditure. No precise statistical data relating to the rate of savings or capital formation is available. The Fiscal Commission (1949-50) refers in its Report† to Colin Clark's estimates of Savings and capital investment in the four quinquennial periods ending in 1938. These estimates are summarised in Table No. 22. I. On the basis of this Table, the Fiscal Commission observes‡ that the rate of over-all investment constitu-

* See the First Five Year Plan, Ch. III, Para. 1.

† The First Five Year Plan, Ch. III, Para. 11.

‡ The First Five Year Plan, Ch. III, Para. 17.

§ See Report of the Fiscal Commission (1949-50), Ch. XV, Para. 206.

* See the First Report of the National Income Committee (1951), Ch. V, Table 5.

† See Ch. XV, paras. 215-16.

‡ Ibid., Ch. XV, paras. 215-216.

TABLE NO. 22. I.

Period	Average Annual Rate of Investment in Crores of Rs.							Rate of Investment as Percentage of National Income	Percentage of Per Capita Savings to Per Capita Real Income
	Industry and Mining	Agricultural Improvement	Irrigation	Other Public Works	Housing and Building	Railways	Over-all Total		
1919-23	26	55	2	6	42	19	150	7.6	9.7
1924-28	11	47	6	6	43	27	140	6.6	10.6
1929-33	10	39	4	4	52	5	114	7.0	9.0
1934-38	12	58	2	4	61	2	159	7.3	11.7
TOTAL	59	199	14	20	198	53	543		

(Source : Report of the Fiscal Commission (1949-50), Ch. XV, Tables 32 and 33)

ting about 7 per cent. of the national income throughout the period was supported by a rate of savings equal to about 10 per cent. of the national income. The Commission adds:

"No comparative figures of savings for post-war years are available but an unofficial estimate based on admittedly inadequate data suggests the actual emergence of dissavings in the years 1946-47 and 1947-48 followed by a negligible amount of savings in 1948-49 when the rate of savings was said to be as low as 1.4 per cent. We cannot accept the correctness of these figures. But there can be no doubt about the post-war trends in general—that the rate of capital formation has declined."*

The Fiscal Commission further expresses the view** that in the present-day conditions, the country will be

* Report of the Fiscal Commission (1949-50), Ch. XV, para. 216.

** Ibid., Ch. XV, para. 215.

fortunate if it achieves the pre-war rate of investment. These fears seem to be confirmed by the Planning Commission. Assuming that the level of per capita national income remains constant between 1948-49 and 1950-51, the Planning Commission computes the national income in 1950-51 (at 1948-49 prices) at about Rs. 8,900—9,000 crores* and gives an estimate as in Table No. 22 II of the saving and investment in the economy in 1951-52. The Planning Commission then concludes:

"Allowing, however, for the fact that the above estimates are in terms of 1950-51 prices and the estimates of national income for 1950-51 estimated earlier is expressed at 1948-49 prices, the proportion of savings may be placed roughly at 5 per cent. of the national income."**

Against this is the estimated pre-war rate of saving of about 10 per cent.

* The First Five Year Plan, Appendix to Part I, para. 13.

** Ibid., Appendix to Part I, para. 19.

TABLE NO. 22. II.

(Year: 1950-51)

Domestic Savings	Crores of Rs.	Domestic Investment	Crores of Rs.
PUBLIC SECTOR (including Rlys.)	98	ON PUBLIC ACCOUNT	185
PRIVATE SECTOR—		ON PRIVATE ACCOUNT—	
Corporate Enterprises	40	(i) Large and Small Scale Industries	80
Unincorporated Enterprises and Personal Savings (residual) of which private savings in—	332	(ii) Transport other than Railways	25
(i) Insurance Policies	40	(iii) Building Construction	100
(ii) Co-operative Banks (Deposits and Share Capital).	25	(iv) Agricultural and Small Scale Industries.	20
(iii) Small Savings	30	Investment Abroad	60
(iv) Provident Funds	15		285
(v) Currency and Scheduled Banks' Deposits.	100		
(vi) Private Savings directly invested in agriculture, small industries, buildings, etc.	150		
(vii) Adjustments	12		
	372		
TOTAL	470	TOTAL	470

(Source : The First Five Year Plan, Appendix to Part I, Para. 19)

Dealing with the five-year planning period as a whole, the Commission expects that in 1955-56 the national income will be higher at about Rs. 10,000 crores,* and that the savings will go up to about Rs. 675 crores**, gradually in the first two years and more

rapidly in later years. On this footing, the resources available internally for investment over the five-year period are estimated at 2,700—2,800 crores, @ which, with the help of sterling balances and external finance,

** Ibid. Appendix to Part I, paras. 20-21.

@ Ibid. Appendix to Part I, paras. 20-21.

* The First Five Year Plan, Appendix to Part I, para. 13.

are expected to support an aggregate investment programme in the public and private sectors of the order of Rs. 3,500—3,600* as shown in Table No. 22. III. The investment programme of large scale industries in the private sector and the sources of such investment are estimated as in Table No. 22. IV. Against this background of the past and the present and the expectations of the future, the Planning Commission in its July 1953 Report expresses its disappointment at—

“The inability of the private sector to maintain the rate of investment according to the plan and programme.”

22. 2. *The Effect of Budget Surpluses.*—The doubts and fears that have been from time to time entertained about the rate of private saving and investment seem to find a reflection in what little statistical data that is available. For example, compared with the pre-partition years, the quantum of savings in the private sector was substantially reduced by the creation of budget surpluses through taxation during 1948-52. This is apparent from Table No. 22. V. As the Table shows, the Central and Part A State budgets had an over-all surplus of Rs. 271 crores and Rs. 19 crores respectively from 1948 to 1952 and capital formation in the private sector was the loser to the extent of these Rs. 290 crores.

* *Ibid.* Appendix to Part I, para. 21.

TABLE NO. 22. III.

Total Investment Expected—1951-56		Crores of Rs.
PLANNED INVESTMENT—		
Public Sector		1,650 Approx.
Private Sector—		
Large Scale Industries	533	
Transport other than Railways	17	550 ..
UNPLANNED INVESTMENT—		
Agriculture, Small Scale Industry, Buildings, etc.	1,300	..
TOTAL	3,500	..

(Source : The First Five Year Plan, Ch. IV, para. 5, Ch. XXIX, para 33, Ch. XXXI, para. 36 and Appendix to Part I, para 21.)

TABLE NO. 22. IV.

(Period: 1951-56)

Requirements of Industries	Crores of Rs.	Sources of Finance	Crores of Rs.
Expansion Programme	233	Corporate Savings	200
Replacement and Modernisation.	150	New Issues	90
Additional Working Capital	150	State Assistance	5
Current Depreciation	80	Industrial Finance Corps.	20
		E.P.T. Refunds	60
		Bank and Other Short term Finance.	158
		Foreign Investment.	80
TOTAL	613	TOTAL	613

(Source: The First Five Year Plan, Ch. XXIX, para. 33.)

22. 3. *Experience of Government Borrowing.*—During the war years, Government was the largest borrower of private savings and there was a steady increase in the outstanding amount of Government of India loans. In post-partition years, though Part A State loans and small savings maintained their position, the Central Government was unable to complete its borrowing programmes. In fact, as appears from Table No. 22. V, it experienced a sharp set-back during 1948-52. Instead of fresh borrowing, there was net repayment during these years, pointing to actual dissaving. The inverse relationship between Central Government budget surpluses and deficits on the one hand and public borrowing on the other is reflected in the Table which shows the parallel but contrary movements of the two series. The Table also indicates that the era of budget surpluses is drawing to a close with a corresponding change in the trends that have been in operation in the post-partition years.

22. 4. *Significance of Continuous Decline in Stock Exchange Values.*—The paucity of savings as a result of top-heavy taxes and the shift of incomes to classes not accustomed to save was also reflected in the diminished

TABLE NO. 22. V.

(In Crores of Rs.)

Year	Increase (+) or Decrease (—) in			Increase (+) or Decrease (—) in	
	Govt. of India Loans	Small Savings	Part A States Loans	Central Govt. Budget	Part A States Budgets
1939-40	+12.3	—6.1	+4.5	..	+1.6
1940-41	+124.4	—26.6	+3.7	—6.5	+2.3
1941-42	+37.3	—13.2	—0.3	—12.7	+3.9
1942-43	+136.8	—2.8	+8.1	—111.8	+6.1
1943-44	+257.9	+25.7	+8.5	—189.9	+9.5
1944-45	+205.5	+40.7	+11.3	—160.6	+3.9
1945-46	+280.1	+62.3	+8.4	—123.4	+11.2
1946-47	+37.6	+51.7	+4.3	—0.6	+8.7
1947-48	—12.7	—40.1	—19.4	—6.6	+8.6
1948-49	—38.7	+38.6	+3.7	+50.9	+7.4
1949-50	—26.2	+22.1	+4.5	+33.3	+4.0
1950-51	—13.7	+32.5	+7.7	+50.2	+1.2
1951-52	—36.4	+46.3	+11.0	+128.1	+6.5
1952-53	+3.5	+45.0	+9.3	—3.8	—3.1

(Source : Reserve Bank of India Reports on Currency and Finance, 1940-41 to 1952-53)

activity in capital markets and the continuous decline in Stock Exchange Values in post-partition years. The extent of the decline as compared to the rise in the pre-partition period appears in Table No. 22. VI. The Table shows the uninterrupted fall in the indices of gilt-edged, fixed yield and variable yield securities at a

time, it must be noted, when all other price indices were moving upwards. The gilt-edged market had a prop in official purchases which absorbed sales by the public and prevented a sharper drop. Table No. 22. VII showing the increase in Government Security holdings of the Reserve Bank of India under two principal heads gives

TABLE No. 22 VI.

(Index Numbers)

Year	Security Prices*			Bullion		Wholesale Prices					Cost of Living (Bombay Index)
	Gilt-Edged	Fixed Yield	Variable Yield	Gold	Silver	Food Articles	Industrial Raw Materials	Semi-Manufactured Goods	Manufactured Goods	General Index	
1938	100	100	100	100	100	..	..	..	..	..	..
1939	95	101	109	112	110	100	100	100	100	100	100
1940	94	108	110	119	124	..	..	..	..	118	107
1941	97	120	121	125	132	..	..	..	..	130	118
1942	94	108	122	162	186	..	..	..	..	159	150
1943	96	124	163	216	239	269	..	..	..	218	219
1944	97	131	184	201	255	247	..	..	..	241	226
1945	97	140	198	226	267	248	..	..	..	244	224
1946	104	141	254	275	316	263	..	..	..	267	216
1947	104	124	195	302	328	292	365	252	277	297	265
1948	102	112	147	318	338	374	431	317	341	367	288
1949	101	103	118	323	347	389	464	328	344	381	292
1950	101	101	121	321	363	410	503	341	348	401	298
1951	98	99	130	316	383	410	608	378	396	439	314
1952	91	92	111	256	326	360	454	347	378	387	321
1953 (Aug.)	92	91	106	247	312	407	489	365	371	410	358

*Upto 1945, old series.

(Source : Statistical Abstract, India, 1950, Tables Nos. 121, 124 and 126 and Monthly Abstract of Statistics, October 1948, Table 57 and September 1953, Tables 66 to 71.)

TABLE No. 22. VII.

(Crores of Rs.)

Year	Holdings of Government Securities (excluding Treasury Bills) by the Reserve Bank of India	
	Investment (Banking Dept.)	Rupce Securities (Issue Dept.)
1939-40	9	15
1940-41	9	46
1941-42	13	21
1942-43	9	30
1943-44	10	22
1944-45	22	21
1945-46	40	21
1946-47	66	8
1947-48	108	21
1948-49	126	18
1949-50	123	98
1950-51	106	130
1951-52	109	172
1952-53	100	168

(Source : Reserve Bank of India Reports on Currency and Finance, 1939-40 to 1952-53).

some indication of the support extended by the monetary authorities, particularly in the post-partition period. The actual scale of purchases must have been much larger. As the Report of the Central Board of Directors of the Reserve Bank of India acknowledges—

“The net purchases of securities by the Reserve Bank of India in 1950-51 had been of the order of Rs. 75 crores.”*

Variable yield securities had no such support to cushion the impact of selling pressure and the fall in their prices was much steeper. The loss during the post-partition years in the market value of equity shares quoted on the principal Stock Exchanges in India as against the gain in the earlier period is summed up in Table No. 22. VIII. The heavy depreciation in stock market prices continued unabated after October 1948 with a further sharp break in March 1952 whereafter the position has tended to stabilize. Referring to these severe price changes, the Fiscal Commission says—

“It is alleged (they) are due not to normal market fluctuations but to extensive speculative operations.”†

* Report of the Central Board of Directors of the Reserve Bank of India for the year ended June 30, 1952, Para. 19.

† Report of the Fiscal Commission (1949-50), Book V, Ch. XV, para. 211.

TABLE No. 22. VIII.

Period	No. of Companies	Total Market Value in Crores of Rs.	Appreciation (+) or Depreciation (—) in Total Market Value in Crores of Rs.	Appreciation as % of August 1939 and Depreciation as % of July 1946
August 1939	554	192.00		
July 1946	554	543.51	351.51	183.1%
July 1946	747	692.69		
October 1948	747	335.55	—357.14	—51.5%

(Source : Reserve Bank of India Bulletin, January 1949, Tables II and III, pp. 15 and 17, and June 1949, Table II, p. 373.)

The Commission studiously refrains from expressing its own opinion on the subject. Hectic speculation can cause heavy upsets—as aided and abetted by a wrong monetary policy it did in 1946-47—but it must be remembered that—

“The long term movement of stock market prices is a derivative of the trend of national economic progress deflected to either side by disturbing monetary and technical factors; that the medium-term movement is an aspect of the trade cycle and its concomitants and that the short period movement is the outcome of market influences.”*

The allegation that speculation—no matter how rampant—can drive the prices of all securities—speculative and non-speculative, equity, fixed yield and gilt-edged—consistently in one direction over a number of years against the general current cannot bear any serious scrutiny. It is contradicted by the experience of the First World War and its aftermath which also constituted a period of violent speculative activity. Table No. 22. IX (page 348) records the fluctuations in stock market prices during these two highly speculative war cycles and correcting them by the general price index brings out the striking difference between the two periods. Obviously, a more fundamental factor, other than speculative manipulation, has been in operation during the second war cycle. A glance at Table No. 22.

* ‘Output’, No. 3, August, 1950, “Stock Exchange Prices”, p. 21. Also see pp. 17-26 for a detailed analysis of war and post-war stock price fluctuations.

VI shows that the unchecked fall has been against a background of rising prices in all other sectors of the economy. This is a significant fact. It implies that existing capital goods in the form of plant, machinery, working mills, factories and other business undertakings—which shares of joint stock companies represent—were under-valued in terms of non-capital goods and new capital goods. Such under-valuation can only be accounted for by the dearth of savings and capital formation. Stocks and shares are the most liquid of investments and the stock market is the paying teller's window at which an investor immediately presents himself whenever he desires to withdraw his savings, either for capital employment, or for making an essential provision like payment of life insurance premium or calls on holdings of partly paid shares, or for incurring any kind of consumption expenditure. The amount the investor can withdraw depends on the market price. If the demand for a particular kind of share is less than the supply, the market price of that share declines. When the demand for all kinds of shares and securities—equity, fixed yield and gilt-edged—is less than the supply, it means that the inflow of savings is less than the outflow, and then the market as a whole declines. When that decline is continuous and uninterrupted at a time when all other prices are rising, as has actually been the case till recently, the conclusion is that replacement savings for maintaining the position are not available and that in fact dissaving is taking place. This is what has been happening in the economy of the country in the post-partition years, though currently it seems that perhaps the trends are again being drawn into alignment.

TABLE No. 22. IX.

Year	First World War			Second World War			Year
	Variable Yield Security Price Index	General Index	“Corrected” Variable Yield Security Price Index	“Corrected” Variable Yield Security Price Index	General Index	Variable Yield Security Price Index	
1914 . . . 7	100	100	100	100	100	100	1939
1915 . . .	101	112	90	97	110	112	1940
1916 . . .	130	128	102	96	128	123	1941
1917 . . .	158	145	100	80	157	125	1942
1918 . . .	194	178	109	76	226	173	1943
1919 . . .	212	190	108	81	239	194	1944
1920 . . .	298	201	143	87	243	210	1945
1921 . . .	287	178	161	105	265	278	1946
1922 . . .	256	176	146	74	287	210	1947
1923 . . .	182	172	106	49	355	174	1948

(Source : Output No. 3, August 1950, “Stock Prices”, Table No. 2, p. 22.)

22. 5. *Significance of Decline in New Issue Activity.*—The unbroken decline in stock market values in opposition to rising prices in all other directions implies an upset in the balance of power between the saving and the non-saving groups in their command over the available resources of the community. Those investors who sell shares to meet current liabilities arising, for example, out of the high cost of living, or to provide capital for an existing or new enterprise, receive much less in real terms than what they invested. Those who have borrowed against their holdings for the purpose of financing expansion projects or new or existing enterprises find themselves in similar difficulties as the overdrafts and loan value of their investment diminishes. This shrinkage of savings and under-valuation of existing capital goods has two effects. First, the process of ‘seasoning’ is arrested. In the absence of replacement savings, there is a slow-down in the outflow of risk capital from concerns that have become established to new ventures, leaving more conservative capital to take its place. Secondly, new issue activity is further discouraged because those who invest in shares of new companies, which have to acquire assets at a high cost, find that their savings evaporate in terms of current stock market prices. For these reasons, industry is compelled into a greater degree of self-financing, and when capital is at all forthcoming—as it seems to be of late—it expresses a preference for debentures or quality preference shares or for further issues by existing concerns and shows marked reluctance to engage itself in

new issues made by recently floated companies. These symptoms appeared in the post-partition period and they indicate, not that capital has been on strike as has been alleged, but that savings have been dwindling and that capital has been in distress.

22. 6. *Evidence of Decline in New Issue Activity.*—The new issue market has remained stagnant in the post-partition years and the amount of capital for which permission has been sought from the Controller of Capital Issues has continued to dwindle from year to year. The consents given by the Controller of Capital Issues are summarised in Table No. 22. X, and though they do not represent the actual capital raised, they are useful indicators of the general trend. The Table also shows the increase in paid-up capital of joint stock companies a striking advance by doubling itself over the war decade in spite of loss through partition. However, the entire amount of the increase did not signify formation of new capital in the private sector. For example, it is estimated that in the post-partition period more than Rs. 25 crores of the paid-up capital was contributed by the State, as must as Rs. 17 crores being the capital of Sindri Fertiliser which was registered as a private limited liability company at the end of 1951. Further, as can be seen from Table No. 22. IX, the amount of bonus issues sanctioned in three years from 1948 to 1951 totalled upto Rs. 35 crores, from which it may be inferred that a sizeable portion of the increase in paid-up capital must have been composed of bonus shares. The issue of such shares merely involved capitalisation

of existing reserves in the joint stock system and did not involve any fresh capital formation. The same was the effect of the conversion of private businesses into limited liability companies, which occurred on a fairly extensive scale, partly with a view to reducing the tax liability and also with the object of inviting public participation in the capital of those concerns. A number of important foreign business houses with industrial, trading and managing agency interest were also registered in the same manner, though in their case it was probably followed by repatriation of the sale proceeds involving the withdrawal of foreign capital from the country. Lastly, much paid-up capital was lost through companies—particularly newly floated ones—ceasing to work without being taken into liquidation, the figures for which are not reflected in Table No. 22. IX. Making these allowances, the joint stock sector nevertheless witnessed a large expansion during the war decade. The advance was not confined to established industries but was broadly diversified. Table No. 22. X gives the

breakdown of the increase in the total paid-up capital under various classified heads and it shows that the steepest rise was in the blanket category—"trading and manufacturing" concerns, which accounted for as much as Rs. 56 crores in 1947-48 and Rs. 30 crores in 1948-49. In fact, the post-partition period is distinguished from the pre-partition period for the sharp increase in paid-up capital as much as the pre-partition period is distinguished from the post-partition period for a rapidly accelerating interest in new capital issues, particularly by newly floated ventures. This can be seen from Table No. 22. IX. The pre-partition gestation period and the post-partition digestive period are, however, parts of a continuous process and complementary to each other. The rapid increase of paid-up capital in the post-partition period represents in a substantial measure the capital called up on partly paid shares subscribed for in the pre-partition boom period. The liability in respect of such payments could not be escaped, and the funds for them were probably found,

TABLE No. 22. X

Year	Consents Granted by the Controller of Capital Issues*						Total Amount Sanctioned	Net Increase in Paid-up Capital of Joint Stock Companies	Paid-up Capital of Companies Liquidated
	Initial Issues	Further Issues				Total			
		Other than Bonus	Bonus	Debentures					
1939-40	..	..	..	..	..	..	13	4
1940-41	..	..	..	..	..	..	6	3
1941-42	..	..	..	..	..	..	16	3
1942-43	..	..	..	..	..	..	11	4
1943-44	58	..	..	..	35	93	18	5
1944-45	70	..	..	..	42	112	35	2
1945-46	114	..	..	..	51	165	35	3
1946-47	211	..	..	..	60	271	55	7
1947-48	101	..	..	..	62	163	90	10
1948-49	65	35	17	..	52	117	59	6	
1949-50	12	34	9	12	43	55	94	7	
1950-51	17	33	9	12	54	71	50	8	
1951-52	23	20	10	3	33	56	..	4	
1952-53	9	30	6	2	38	47	..	7	

* (Adjusted for the period 1943-47 for which combined statistics were published in Reports Nos. 1 to 6.
(Source: Reports of the Controller of Capital Issues Nos. 1 to 32, Statistical Abstract, India, 1950, Tables Nos. 130 to 137, and Monthly Abstract of Statistics, December 1951 and September 1953.)

TABLE No. 22. XI.

(In crores of Rs.)

Year	Increase or Decrease (—) in Paid-up Capital of Joint Stock Companies							
	Banking	Transport	Plantation	Mining	Trading and Manufacturing	Cotton Mills	Miscellaneous	Total
1939-40	—0.4	0.6	0.3	0.2	6.1	1.4	5.1	13.3
1940-41	—1.4	1.6	—0.1	0.2	5.4	2.2	—2.0	5.9
1941-42	1.2	0.4	—0.1	0.3	10.7	0.9	2.2	15.6
1942-43	2.6	—1.1	0.5	0.1	4.3	1.9	2.6	10.9
1943-44	3.8	0.5	3.0	0.6	2.8	1.5	5.4	17.6
1944-45	9.5	0.4	1.8	0.4	13.3	2.8	7.0	35.2
1945-46	6.5	6.1	1.8	1.7	9.1	1.8	8.3	35.3
1946-47	3.6	9.5	1.6	..	20.8	3.9	15.8	55.2
1947-48	8.1	1.4	2.2	6.8	55.7	8.9	7.0	90.1
1948-49	—0.4	7.8	2.3	4.4	30.2	5.0	9.5	58.8

(Source: Statistical Abstract, India, 1950, Tables Nos. 130 and 131.)

as often as not, by selling existing holdings, which added to the pressure of sales in the open market. The overload taken in the earlier gestation period would have been in any case difficult to digest and was bound to precipitate a break in prices. However, the break remained unchecked and developed into an uninterrupted fall as long liquidation set in on the investing class finding the old no less than the newly accumulated investments progressively too heavy and beyond its means to carry at ruling prices. That was because political changes altered its composition and attenuated its numbers and crushing taxes, a high cost of living and other adverse economic developments forced it into dis-saving in subsequent years. Hence, while on the one hand the paid-up capital continued to increase at a remarkable pace in the post-partition period, major new issues on the other hand were few and far between, with the emphasis resting on preference shares and debentures carrying high rates of interest. Formation of new risk capital was at a low ebb. In fact, as can be gathered from Table No. 22. IX, the amount of further new issues (excluding bonus shares) for which consent was given by the Controller of Capital Issues in 1952-53 was as little as Rs. 30 crores and that for initial issues by newly floated ventures only Rs. 9 crores, the smallest on record for any year. The process of adjustment now seems to be nearing its end. The consents granted by the Controller of Capital Issues have increased in the current year, pointing to a possible revival of new issue activity, and other trends also—as noted in paras. 22.3 and 22.4 above—seem to confirm the signs abroad that stock market conditions may gradually become more favourable if the policies are revised to leave a margin for savings and investment and if reasonable economic policies are pursued so that the general conditions continue to improve.

22.7. *Comparison with the pre-Second World War and the First World War Periods.*—The progress made in the joint stock sector in the period of the Second World War may be considered in the light of the experience of the First World War and the period immediately before the Second World War including the years of the great depression. Table No. 22. XII makes this comparison. It shows that in the period of the great

depression, much paid-up capital was dropped in the early years, and that the lost ground was only retrieved at the end of 1938, after which the rate of increase quickened upto about Rs. 11 crores per annum. A more comparable period is that of the First World War, when the paid-up capital almost quadrupled itself, giving an annual increase of about Rs. 19 crores. Correspondingly in the period of the Second World War, the paid-up Capital expanded two and a half times and the average annual rate of increase was Rs. 43 crores. If the rise in prices that occurred during the interval is taken into account, it becomes clear that the progress in the joint stock sector in the decade of the Second World War has not been as remarkable as at first sight appears. An assessment in terms of national income points to the same conclusion. Figures of national income comparable to the estimate of Rs. 8,730 crores for 1948-49 are not available for earlier years. Colin Clerk's estimate* of national income for the period 1919-23 is approximately Rs. 2,000 crores per annum, K. T. Shah and K. J. Khambata's estimate** for 1921-22 is Rs. 2,364 crores and Sir M. Visvesvaraya@ puts it at Rs. 2,223 crores for 1922-23. Table No. 22. XIII presents a very rough picture on the basis of these estimates. Obviously, the period of the First World War stands on a higher plateau than that of the Second World War, with the trough of the Great Depression Period in between. It therefore does not seem wrong to surmise that, though the Second World War period marked a distinct improvement on the static position of the immediately preceding period which included the years of the great depression, notwithstanding that striking expansion, the rate of increase relatively lagged behind the rate achieved in the period of the First World War. The needs and requirements of the development period that lies ahead are bound to make greater demands. In this respect, the provision made by the Planning Commission as recorded in Table No. 22. IV appears to be an underestimate. In any event, the utmost exertion will be necessary if the targets are to be attained. All the efforts, therefore, must be directed at stepping up the rate of saving and investment and in creating conditions which make this increase possible in the context of a mixed economy and a democratic form of government.

TABLE NO. 22. XII.

As on 31st March	Paid up Capital of Joint Stock Companies		Increase or Decrease (—) in Paid up Capital during the Period in Crores of Rs.	
	Total Crores of Rs.	Index	Total	Rate per Annum
<i>First World War</i>				
1914 . . .	72	100	51	8
1920 . . .	123	171		
1925 . . .	276	383	153	31
1914-25 . . .	..	..	204	19
<i>The Great Depression</i>				
1928 . . .	278	100	—22	—7
1931 . . .	256	92	30	5
1937 . . .	286	103	..	..
1938* . . .	279	100	11	11
1939 . . .	290	104	..	..
1928-39 . . .	..	..	11	1
<i>Second World War</i>				
1940 . . .	303	100	121	20
1946 . . .	424	140		
1951** . . .	772	225	348	70
1940-51 . . .	..	..	469	43

* Separation of Burma.

** Partition in 1947-48.

(Source : Reports of Joint Stock Companies in India, Department of Commercial Intelligence and Statistics.)

* See Table No. 22. I above.

** K. T. Shah and K. J. Khambatta, "Wealth and Taxable Capacity of India".

@ M. Visvesvaraya, "Planned Economy for India", Table III, p. 400.

TABLE NO. 22. XIII.

Period	Increase in Paid up Capital of Joint Stock Companies Crores of Rs.	Average rate of Increase of Paid up Capital per Annum Crores of Rs.	Estimate of National Income per Annum Crores of Rs.	Annual Increase in Paid up Capital as Percentage of National Income %
1920-25 . . .	153	31	2,200 Approx.	1.4
1946-51 . . .	348	70	8,700 Approx.	0.8

22.8. *Impediments to Capital Formation.*—Many factors have tended to impede the formation of capital in the private sector and among the most important have been the shifts in the distribution of national income and the high level of taxes, particularly direct taxes on income and profits. Their repercussions have been examined in some detail in the answers to Questions Nos. 13, 14 and 17 above. These and the other causes may be briefly enumerated as under:—

(a) *Attenuation of the Investing Class in numbers and capacity.*—The wealthy class of princes and zamindars has disappeared as a result of political changes and the urban population, particularly the middle class who formed the backbone of capital investment, has been impoverished. As the Fiscal Commission acknowledges—

"There is no doubt that increased purchasing power is now passing to population who have not been in the habit of saving and investing, while owing to higher costs of living and other causes the margin of savings available with those classes who usually invest in industries is being steadily reduced."

(b) *Multiple taxation through high income-tax, super-tax and corporation tax as well as E. P. T. and B. P. T. (now abolished).*—These have reacted on the ability to save and the

* Report of the Fiscal Commission (1949-50), Ch. XV, para. 212.

incentive to invest and led to capital erosion because of the insufficiency of the allowances for renewal, replacement and rehabilitation.

- (c) *The ravages of partition, the consequent dislocation of the economy of the country and the continuance of controls.*—The destructive influence of these factors has abated, particularly after 1953, but in the post-partition period they impaired the normal working of the economy, throttled business activity and diverted large amounts of black-market money into hoards and anti-social activities.

- (d) Futile and psychologically adverse legislation—for example:—

(i) dividend limitation; and

(ii) capital gains tax.

Both these have now been abolished.

- (e) Unsound notions of what constitutes "fair return on capital" as illustrated in

- (i) Government's rejection of the Tariff Commission's considered recommendation that there should be a small increase in the return on Tata Iron and Steel Company's gross block, even though the rate of 8 to 10 per cent. on gross block adopted by earlier Tariff Boards could not be deemed reasonable in the current changed circumstances when tax liabilities and replacement costs have increased so much;

- (ii) Government's refusal in the case of electric power industry to raise to 6 per cent. the over-riding limit of 5 per cent. on the net block or depreciated cost of fixed assets prescribed under the Electricity Supply Act which was passed in 1948 when the cheap money policy was at its peak. To repeat the complaint made by the Federation of Electricity Undertakings of India—

"The bank rate may go up, the interest rate on gilt-edged securities may in sympathy move forward, the fully secured loans of the Central Government's own Industrial Finance Corporation may even demand an interest rate as high as 6½ per cent.; and all these by executive acts moving in response to the day to day pressures of economic laws. Yet our request for a modest increase of one per cent. (making six per cent.) in the basic rate of ordinary equity risk return to be permitted to the investors in the electric supply industry has to be taken before the seat of Government itself, and for two years has been kept waiting in vain to get that far. I really wonder whether one could anywhere find a parallel case where a Government, having rightly given absolutely top priority to schemes for the development of electric power in its plans, has been so callously or indifferently ignored, in the way that seems to be happening here, the very essentials necessary to the development of a substantial part of that urgently needed power."*

- (f) Discrimination against capital as evinced in the frequent oral and sometimes actual departures from the April 1948 policy declaration on nationalisation—for example:—

- (i) the recent overt threats to nationalise banking and insurance;

- (ii) the nationalisation of air transport in contravention of the recommendation made by the Air Transport Enquiry Committee, 1949, from which the Chairman of Air-India, Ltd., drew the following conclusions; namely, "that private enterprise should not rush into a new field without making sure that the total productive capacity so created will not exceed the available demand and that the industry will be allowed to function with a reasonable measure of freedom; that a detailed economic plan, once accepted by Government, should not be changed arbitrarily without careful consideration at the highest level and without consultation with those concerned; that the appointment of high power commissions does more harm than good if their recommendations are to be disregarded, as happened in the case of the Air Transport Enquiry Committee's Report.

Finally, that safeguards instituted in the form of statutory authorities for control or licence purposes should not be allowed to be destroyed by constant interference by the executive, as happened in the case of Air Transport Licensing Board."*

- (g) The inequitable and confiscatory terms of compensation against the spirit, if not the letter, of Article 31 of the Constitution—as in the case of the nationalised air transport companies whose assets were arbitrarily acquired at much below current market prices. As the Chairman of Air-India International protested:—

"The principle of paying to the owners the market value of assets compulsorily acquired is a well proven and accepted one which has been invariably adopted by democratic Governments and public bodies, in India and elsewhere. The fact that the assets may have increased in value since their original purchase or creation has never been allowed to invalidate this eminently sound and fair principle. In the case of the nationalisation of the Indian airlines, it has been wholly set aside by Government."**

The Chairman's speech at the meeting of Air-India, Ltd., was more forthright in pointing out as follows how enterprising investors who had risked their savings in a pioneering venture were mulcted of their dues:—

"The use of the term 'compensation' in the debate in Parliament and in the Act has created the wrong impression in some quarters that compensation for the loss of business, licences, profits, etc., will be paid to the nationalised companies in addition to a reasonable price for their assets. Such compensation, if payable at all, will be purely nominal—the maximum is fixed at Rs. 10,000—while nothing will be paid towards the heavy development expenditure incurred by the operators in the course of opening new routes, etc.,..... the nationalised companies will receive about one-fifth of the world price for Dakotas, Vikings and Skymasters and about 50 per cent. for Constellations. Even if we ignore world prices, the figures fixed for Dakotas will be about half the Indian market prices. To that extent, therefore, it may legitimately be contended that the terms on which the air transport industry is being taken over contain an element of expropriation."*

- (h) Expropriatory labour awards as in the case of—

- (i) the Cawnpore Electric Supply Corporation award (subsequently set aside on technical grounds) which ordered the distribution of Rs. 75 lakhs of the shareholders' capital amongst some 2,000 employees;

- (ii) the recent case of the Madras Electric Tramways where the Appellate Tribunal has ordered that 50 per cent. of the unused reserves belonging to the shareholders of the Company should be distributed among the workers.

- (i) Unwarranted discrimination practised against investors as, for instance, in the case of—

- (i) the Sholapur Mills where the rights of investors (as represented by the minority group of shareholders, which was responsible for exposing the mismanagement after years of concentrated effort spent in compelling a strangely reluctant Government to act) were wholly ignored when constituting the new management under the Sholapur Spinning and Weaving Company (Emergency Provisions) Act, 1950, and where what, in declaring the Act *ultra vires* of the Constitution, the Supreme Court described as nationalisation without compensation was sought to be practised by Government for the benefit of labour at the expense of investors;

- (ii) the nationalised airline companies when an attempt was made in the Parliament (no matter what justification there might have been in the case of a particular company) to interfere with the basic contractual rights of Preference and other classes of shareholders *inter se*;

- (iii) the latest Nagpur Textile Mills award, where with reference to the reserve funds belonging to investors the Chairman of the Madhya Bharat Industrial Court has gone

* Chairman's address at the Annual General Meeting of Air-India, Ltd., June 1953.

** Chairman's address at the Annual General Meeting of Air-India International, Ltd., June 1953.

* Presidential address at the Annual General Meeting of the Federation of Electricity Undertakings of India, September 1953.

to the extent of declaring that "it would not be proper to hold that the owner of the machinery would have an absolute right or control over such fund" and further that "labour should have greater control over the fund than the investor";

- (iv) the numerous labour tribunals' bonus awards where varying rates of return over capital are arbitrarily assumed in determining the percentage of profits to be distributed among workers as bonus and the rights and interests of investors are belittled or ignored at the whims and fancies of the adjudicators concerned.

- (v) The volume and pace of welfare legislation as for example industrial housing Schemes Employees' State Insurance, Provident Fund, retrenchment gratuity, lay off benefit, etc.—In other countries, such benefits have followed on improvement in productivity per man hour but here it has been otherwise. The Fiscal Commission quotes the following from the Chairman's speech at the annual general meeting of the Tata Iron & Steel Co., Ltd., held in August 1949:—

"Whereas the average labour cost per ton of finished steel has gone up from Rs. 31.54 in 1939-40 to Rs. 92.80 in 1948-49, the average output of finished steel per employee has declined from 24.36 tons in 1939-40 to 16.30 tons in 1948-49. While the increase in labour cost can be explained to a great extent by the increase in the cost of living, it is the decline in the output per head by nearly one-third which is an index of the prevailing malaise and which causes serious anxiety. The number of men employed in (your) company is not only several times the number required for the same output in advanced countries like America and Europe, but is far in excess of the number of men required even under Indian conditions. This is particularly so in the maintenance departments where, ironically enough, the men who have recently had the largest increase in emoluments have given the greatest trouble. The output per man in our structural shops is half a ton per month, whereas the average output per man in similar shops in the United States is 5 tons per month.....We have been advised by experts that in our maintenance departments the majority of the men are working at one third to half of their capacity even under normal Indian conditions."*

In the circumstances, the deadweight load on industry has continued to increase and its inflated cost structure has tended to rigidity, thus reducing the return on capital employed.

The cumulative effect of the foregoing factors has been to cause serious misgivings in the minds of investors, to curtail the scope of profitable enterprise and impede formation of risk capital in the private sector. The Planning Commission is reported to have estimated that new investment in industry has been about Rs. 60 crores during the first two years of the Plan against a rate of investment of the order of Rs. 50 crores per annum provided for in the Plan. If the targets are to be reached, it is clearly necessary to create conditions favourable to investment in industry. In effect,

* Quoted by the Fiscal Commission (1949-50) in its Report, Ch. XVII, Para. 240.

and labour policies in particular must be suitably revised so that the margin of savings may expand and opportunities may be restored to equity capital to earn a fair reward for the risks it undertakes.

22. 9. *Shift in the Sources of Capital Formation.*—The relative slowness in the rate of capital formation has been accompanied by a shift in the sources as between individuals, corporations and other institutions. The middle classes who were capable of saving and had a mind to invest have suffered a major eclipse. The precipitate rise in prices and cost of living have destroyed their capacity to save and even compelled them into dissaving. The high level of income-tax plus super-tax has squeezed out the margin of savings of the upper class and deflected savings away from fruitful investment. Accordingly, the emphasis has shifted from individual to institutional investors.

22. 10. *Financial Resources of Banks and Insurance Companies.*—The growth of the banking and insurance habit has led to a large accumulation of assets with banking and insurance companies, which is reflected in Table No. 22. XIV (page 352). The introduction of the State Provident Fund and other similar schemes has also had the effect of canalizing funds into the hands of institutional investors. This change in the character of the machinery through which savings are collected has directly led to a corresponding change in the channels of capital formation. In conformity with law or custom, a large proportion of such savings has been utilised for investment in gilt-edged securities. This is apparent from Table No. 22. XV which gives the

TABLE No. 22. XIV.

(Crores of Rs.)

End of	Scheduled Banks' Deposits	Life Insurance Funds
1940	202	62
1941	238	69
1942	353	76
1943	539	84
1944	674	95
1945	802	108
1946	883	117
1947	907	130
1948	875	151
1949	760	173
1950	754	182
1951	748	196
1952	715	—

(Source : Reserve Bank of India Statistical Tables Relating to Banks in India, 1951 (Tables Nos. 1, 5(i) and 5(ii) and 1952 (Table No. 6), and Government of India Insurance Year Books.)

TABLE No. 22. XV.

(Crores of Rs.)

End of	Investments of Scheduled Banks				Assets of Indian Insurance Companies		
	Government Securities	Others		Total	Government Securities	Shares of Indian Companies	Total Realisable Assets
		Shares and Debentures	Total				
1940	..	..	..	91	41	5	76
1941	..	..	..	123	47	7	84
1942	..	..	..	218	55	8	97
1943	..	..	..	297	63	9	107
1944	..	..	..	381	75	12	122
1945	..	..	..	433	88	13	138
1946	390	..	35	425	94	15	151
1947	409	..	41	450	97	19	168
1948	396	..	45	441	107	25	193
1949	308	13	40	348	116	30	218
1950	316	14	45	361	117	33	226
1951	254	13	48	302	123	34	250
1952	276	13	48	324	..	..	..

(Source : Reserve Bank of India Statistical Tables Relating to Banks in India, 1951 (Tables Nos. 2, 5(i), 5(ii) and 16) and 1952 (Tables Nos. 6 and 7(ii) and Government of India Insurance Year Books.)

tribution of the investments of scheduled banks and the assets of Indian Insurance Companies over the last decade. In the result, industry has had to rely in a measure on bank advances for purposes of working capital, as is clear from Table No. 22. XVI. In addition the credit from the banking system for working capital, there has been a growing recourse to loans from Industrial Finance Corporation. This is apparent in Table No. 22. XVII which gives the amounts of loans applied for and sanctioned by the Corporation in its inception. The difficult market conditions and many competing demands have thus made for an increasing resort to institutional agencies for short and medium term finance.

TABLE No. 22. XVI.

End of	Bank Advances		
	Industry	Total	Advances to Industry as Percentage to Total
	Crores of Rs.	Crores of Rs.	%
1	142	482	29
2	160	519	30
3	203	627	32
4	186	548	34

Source: Reserve Bank of India Statistical Tables Relating to Banks in India, 1951 (Table No. 17 (1)).

TABLE No. 22. XVII.

As at 30th June	Loans from Industrial Finance Corporation		
	Applications Received for	Amount Sanctioned	Total Amount Outstanding
	(Crores of Rs.)	(Crores of Rs.)	(Crores of Rs.)
1	10.33	3.42	1.33
2	8.76	3.77	3.42
3	5.48	2.39	5.66
4	7.30	4.45	7.25
5	8.26	1.43	9.87
TOTAL	40.13	15.46	..

Source: Annual Reports of the Industrial Finance Corporation of India.)

2. 11. *Self-Financing By Industry.*—Industry has been able to fill all its requirements by borrowing; it has had to rely increasingly on retained earnings for the purpose of financing its replacement and expansion programmes. Table No. 22 XVIII (page 353) re-

TABLE No. 22. XVIII.

Year	(Crores of Rs.)		
	Total Corporate Income Assessed less All Taxes	Dividend Amount Covered by all Income-tax Returns	Difference Between Columns 2 and 3
11	37.82	11.83	25.99
12	37.10	13.83	23.27
13	52.63	17.85	34.78
14	58.43	23.43	35.00
15	52.99	29.80	23.19
16	33.00	30.89	22.11
17	37.35	29.89	7.46
18	70.55	37.08	33.47
19	86.38	41.43	44.95
20	101.92	40.94	60.98

Source: Central Board of Revenue All-India Income-tax Revenue Statistics, 1940-41 to 1949-50.

cords, without adjustment, the net assessable income (after providing for depreciation) of companies after deduction of income-tax and super-tax as well as the income under the head "dividends" appearing in income-tax returns for different years. It must be recognised that the income of a large number of foreign companies is included in the total assessable income noted in the Table and further that the dividend income reflected in income-tax returns does not fully cover the entire amount of the dividends distributed by Companies. Making allowance for these adjustments, it is nevertheless clear that large funds are retained by Companies for their own use. The Planning Commission reports that—

"In the private sector, the profits of corporate enterprises engaged in industries assessed to income-tax in 1950-51 were about Rs. 98 crores. Of this, after allowing for tax and dividend payments, about Rs. 34 crores is estimated to have been ploughed back."

This brings out the vital role played by ploughed back profits in the formation of new capital in the corporate sector. The large percentage of retained earnings which represents ploughing back of profits by industry compares favourably with the rate in the U.K. where it is estimated to average at 60 per cent. of the corporate income and in the U. S. A. where a more variable average is estimated at 50 per cent. To the reserves built up out of such retained earnings must be added the provision for depreciation. These provisions at the depreciation rates allowed for purposes of income-tax for the years 1946 to 1950 in respect of concerns covered by the Census of Manufacturing Industries are set out in Table No. 22. XIX. Assuming an average rate of Rs. 20 crores per annum for retained earnings and Rs. 10 crores per annum for depreciation reserves, it may be surmised that a sum aggregating in the neighbourhood of Rs. 300 crores has been available from these two main sources for capital formation in the industrial sector during the war decade.

TABLE No. 22. XIX.

Year	(Crores of Rs.)	
	Depreciation Provision Allowable for Income-tax Purposes	
1946	11.45	
1947	12.63	
1948	13.99	
1949	16.35	
1950	17.89	
TOTAL	72.31	

(Source: Census of Manufacturing Industries, 1946-50.)

22. 12. *Conclusion.*—The trends discussed in the preceding paragraphs are reflected in detailed statistical studies of structural changes in industry now being carried out by various institutions. These studies illustrate in statistical terms the difficulties of raising new equity capital, the depletion of cash and investments, the reliance on bank advances and other borrowing and the predominance of self-financing through retained earnings and depreciation reserves. They thus serve to confirm the conclusion that there has been a tendency for a shift in the sources of capital formation as between individuals, corporations and other institutions. Whether such a shift is in the best interests of a developing economy is however an open question. Ploughing back of profits, while good within limits, leads either to monopoly aggrandisement by giant corporations† when carried too far or to hypertrophy of existing industries when they expand beyond the optimum point through easy accumulation of funds. The particular industries and concerns where funds accumulate quickest are not necessarily those commanding a top priority from the development point of view. Again, it is a question how far it is desirable that the savings now being generated in the other parts of the system should tend to investment in fixed-interest and gilt-edged securities instead of gravitating to risk-taking productive enterprise. If progress is to be achieved, it is essential that risk capital should engage itself more freely than new in new ventures opening out new lines of activity and sponsoring more diversified pursuits. This requires an active capital market and a body of investors with the capacity to

save and a willingness to risk such savings in hazardous enterprises in the expectation of future rewards higher than any obtainable on "safe" investments. Expectation of such rewards cannot survive for long the present grasping demands of labour, the taxing authorities and Government combined. It follows that the tax, labour and general economic policies must be suitably re-orientated so that the hard-pressed and virtually defenceless investor may come into his own and the capital markets may be revived to speed up the flow of savings to those points where they can be most usefully employed to further the economic development of the country.

Question 23.—Do you think that tax relief in respect of persons in the middle-income group would assist the growth of savings or mainly promote consumption?

23. 1. Tax and Income Changes in Middle-income Group.—The shift in incomes and the burden of taxation have been dealt with in some detail in the answers to Questions 13 and 14 above. Breaking up the middle-income group into three classes—lower, middle and upper—the critical percentages regarding tax and income changes from 1940-41 to 1949-50 are set out in Table No. 23. I. The entire middle class has undoubtedly suffered under recent developments, relatively less by

reason of the increase in the burden of direct taxation and more by reason of the high cost of living. The group has been overstrained in its attempt at maintaining a comparatively inelastic standard of life out of fixed incomes which have failed to keep pace with the steep rise in prices and whose purchasing power has dropped between a half and a third depending on the bracket of the middle-income class. In their case, inflation has imposed a tax more burdensome and much heavier than any direct tax. The demands made by the high cost of living, particularly in matters like clothing, housing, conveyance charges and education especially, have forced them to draw upon their past savings which are being rapidly exhausted. So far as the lower middle-income group is concerned, its contribution in terms of direct taxes is small and it can be relieved only through a reduction in prices or through an increase in income. The tax contributions of the middle and particularly the upper middle-income groups are larger and it is necessary and desirable that they should have tax reliefs in the same manner as is available in other countries, namely, through childrens', dependents' and house-keeping allowances, by splitting up a married man's income into two for tax purposes and by raising the exemption limit for life assurance premia from Rs. 6,000 to Rs. 12,000 and from a sixth to a fourth whichever of the two is lower.

TABLE No. 23. I.

Middle-Income Group	Tax as Percentage of Gross Income in		Net Per Capital Income		Percentage Increase in 1949-50 over 1940-41 %
	1940-41	1949-50	1940-41 Rs.	1949-50 Rs.	
Lower—					
(Under Rs. 5,000)	2.2	2.9	2,173	3,245	50
Middle—					
(Rs. 5,000—10,000)	4.5	5.8	5,544	6,552	23
Upper—					
(Rs. 10,000—25,000)	8.4	13.0	11,082	13,035	18

(Based on Table No. 14. X.)

23. 2. Tax Relief Will Arrest Dissaving.—Grant of tax relief to the middle-income groups will check dissaving, which, it is suspected, is taking place in the middle class group, and will substantially assist the growth of savings in respect of the upper middle-income groups. In any case, the middle class has for years taken the strain and stress of the inequitable burden of inflation and it would be but fair and proper to move the terms of trade in its favour. The group is not addicted to conspicuous consumption; responsibilities of family life are well recognised and the instincts of thrift and saving with a view to providing for old age and other contingencies are deeply ingrained. By and large, therefore, tax relief will not stimulate promiscuous consumption, but will arrest the process of dissaving and promote to some extent the growth of savings. At the same time, it will help in some measure to adjust the unequal burden that has been cast on the middle-income group and which for years it has so patiently borne till, as is now generally feared, the breaking-point has been reached.

Question 24.—The Planning Commission have given an estimate of the rate of progress in regard to national income and consumption standards on the assumption of 50 per cent. of the additional output going into investment each year after 1956-57. What measures in the field of taxation are necessary if this assumption is to be realised?

24. 1. Proposed Rate of Saving.—Capital formation is the key to the Five Year Plan. The Plan has assumed that at the end of the five-year period, that is, from 1956-57 onwards, the rate of saving should increase by the equivalent of 50 per cent. of the additional income accruing each year. This rate of 50 per cent. of the new output implies a progressive increase in the rate of total national saving. On the basis of the additional incomes estimated in the Plan, it is proposed that the rate of saving should increase from about 6½ per cent. of the national income in 1955-56 to approximately 11 per cent. by 1960-61 and to 20 per cent. by 1967-68 at which level it would be stabilized. In money terms, what is contemplated is an increase in the amount of annual savings from about Rs. 675 crores in 1955-56 to approximately Rs. 3,000 crores by 1967-68 when the maximum rate of savings at 20 per cent. of the national

income takes full effect. A progressive increase in savings of the magnitude involved will not be easy to realise.

24. 2. Taxation and the Rate of Savings.—The main emphasis of the Plan is on agricultural development. As a result, the additional incomes will be generated particularly in the primary and tertiary sectors. It is these incomes which will have to be mobilised or impounded. As has been pointed out in the answers to Questions 18 and 20 above, the means whereby national savings can arise are private investment through the working of the capital market, public borrowing—voluntary or enforced—, taxation indirectly to restrain consumption and directly to yield budget surpluses and inflation which is an indirect form of taxation. It is obvious that in order to mop up as much as one-half of the newly generated additional incomes in the agricultural and rural areas, the small savings movement will have to be encouraged and new techniques of borrowing devised as suggested by the Fiscal Commission.* These will have to be supplemented by appropriate measures in the field of taxation. The scope and scale of agricultural income-tax will have to be enlarged and land revenue will have to be suitably revised. Sales tax on articles of general consumption, moderate indirect taxes like the salt tax, and excise duties of the kind now levied on tobacco will have to be exploited with thoroughness so as to increase the coverage by spreading the net of taxation as widely as possible. The dispersal of the additional incomes over a large area and among a large mass struggling on the brink of subsistence renders it extraordinarily difficult to throw the burden of the cost of development on the shoulders of those who receive its benefits. The temptation to make up on the savings what is lost in the roundabouts will have to be resisted. Any increase in the level of direct taxes on non-agricultural income will only lead to diversion of resources from the private to the public sector and defeat the objects of the Plan which contemplates large private investment over and above the public outlay. If the private sector is starved of funds, the Plan will be unbalanced by its

* See Report of the Fiscal Commission, 1949-50. Ch. VII and Ch. XV, para. 212.

inflationary effects which will be as bad as those arising from unlimited deficit financing.

24. 3. *The Rate of Saving—Limiting Factors.*—In view of the political pressures, a judicious tax policy will be difficult to devise or enforce. The gap between savings and additional incomes that is left uncovered by private investment and public borrowing on the one hand and taxation on the other will have to be closed through some system of compulsory savings which would scoop the extra purchasing power pumped by development schemes into the primary and tertiary sectors. Taxation by itself will not be able to absorb, nor can it be pushed to the point of absorbing, all the surplus that remains after private and public borrowing. As W. A. Lewis observes—

“In a democratic country efforts to cut consumption or to keep it low in favour of investment are sure to be resisted. A Government may get away with planning for as much as 15-20 per cent. of the national income to be used for gross investment but if it goes further than this it will meet considerable resistance.”*

In an underdeveloped economy like that of India with a growing population, the limits upto which internal savings can be mobilised for development purposes are more rigidly set. If the view expressed by Colin Clark in his Capper Moore lecture be accepted, any increase in the rate beyond 10 per cent. of the national income is likely to be offset by inflation. This observation finds some support in the past experience, as illustrated in Table No. 22. I, that in normal circumstances the rise tends to be overshadowed by the price increase in the national income, dragging down the rate of savings (as seems to have happened during all the years of inflation since the war). The fact that the growth of expenditure is likely to be productive in that it is expected to be accompanied by real additions to the national income may perhaps modify the percentage in an upward direction, but unless, either through education, propaganda or habit, the people of the country develop a tolerance for a higher rate of saving as an essential condition of planning by democratic as opposed to totalitarian methods, the problem will not be effec-

* W. A. Lewis, *Principles of Economic Planning*, p. 54.

tively solved either by taxation alone or by taxation in combination with agencies promoting saving and investment.

Question 25.—Do you accept the view that some regulation of consumption standards is desirable as a means of releasing larger resources for development? If so, what part, in your view, can tax policy play in this process and what should be the relative role of direct and indirect taxes in achieving the purpose?

25. 1. *Consumption in Relation to Investment.*—As pointed out in the answers to Questions 18, 20 and 24 above, a high rate of investment is the king-pin of the plan for development. No matter the means by which the rate is made effective, in its essence it implies curtailment of current consumption by the community so as to leave a surplus out of the national income. The Planning Commission therefore says:—

“For the country as a whole, the resources that can be applied to development depend on the level of aggregate output that can be attained and on the consumption requirements of the community. The larger the output and the lower the consumption requirements, the greater would be the productive resources available.”*

The large national incomes of advanced countries provide ample room for large *per capita* consumption as well as large national savings. However, as mentioned in the answer to Question 5 above and as is evident from Table No. 25. I (page 131) in underdeveloped economies like that of India, there exists very little margin for capital accumulation once the requirements of the population for food and other necessities of life have been satisfied. It may be admitted that for underdeveloped countries aiming at rapid progress, curtailment of consumption is more necessary than in the advanced countries. At the same time, from the immediate personal point of view of the individual, a reduction in consumption standards is not only highly undesirable but also beset with serious political, social and economic difficulties. In this lies the dilemma.

25. 2. *Methods of Consumption Restriction.*—Restriction of consumption may be enforced directly by physical

* The First Five Year Plan, Ch. III, Para. 6.

TABLE NO. 25. I

Item	Group Distribution of Consumer Expenditure as Percentage of Total			
	U. K. (1938)	U. S. A. (1938)	India (1938-39)	India (Rural) (1949-50)
Food	30.1	21.8	60.5	66.31
Clothing	8.8	8.4	9.8	8.68
Services	11.3	19.1	6.6	4.68
Housing	11.5	14.1	6.0	0.57
Fuel	4.6	4.1	2.1	3.25
Household Goods	6.7	6.5	3.0	2.47
Personal Effects	4.1	3.7	2.1	0.29
Footwear	1.7	2.0	0.7	0.84
Tobacco	4.1	2.7	4.7	2.59
Alcoholic Drinks	6.6	5.1	1.1	0.78
Amusements	1.5	1.8	0.3	0.53
Reading Matter	1.5	1.1	0.6	0.04
Public Transport	3.8	1.9	1.6	..
Private Transport	3.0	6.7	0.6	..
Communications	0.7	1.0	0.3	..
Ceremonials . . . . .	..	..	..	7.21
Miscellaneous . . . . .	..	..	..	1.76
TOTAL	100	100	100	100

(Source: Desai, R. C., *Consumer Expenditure in India, and National Sample Survey, Rural Household Budgets, July 1949-June 1950.*)

rationing or it may be indirectly induced either by voluntary abstinence through promotion of a higher rate of savings or by compulsory abstinence through imposition of higher taxes. The questions of savings and taxation are closely inter-related and accordingly an appropriate tax policy is of the utmost importance.

25. 3. Tax Policy and Control of Consumption.—The relative role of direct and indirect taxes in a policy aiming at control of consumption has been described in answer to Questions 2 and 6 above. Broadly speaking, direct taxes cannot succeed in keeping down consumption. In respect of groups that are well off, it is the margin of savings which dwindles, whereas in the case of the middle and the lower middle class groups, such taxes result in dissaving and ultimately compel a marginal reduction in consumption quite out of proportion to the hardship and sacrifices involved. Dissaving or reduction in the rate of saving has adverse effects on the productive mechanism and reduces the rate of capital formation. In other words, the gain accruing from the comparatively small curtailment of consumption through imposition of direct taxes is outweighed by the more serious and permanent losses inflicted in other directions.

25. 4. Advantage of Indirect Taxes.—The relative advantage clearly lies in the direction of outlay taxes. Instead of being limited to the fractionally small group on whom the direct taxes fall, suitable indirect taxes would have a wider coverage and at the same time could help to restrict consumption without adversely reacting on the rate of saving and investment. In a sense, such a change in proportion would restore the balance of the tax structure. Since the additional incomes under the development plan would be generated in the primary and tertiary sectors, it would be not inequitable to draw off to the public exchequer a portion of these incomes. Only indirect taxes would distribute the burden broadly by reaching incomes that escape direct tax but benefit most under the development schemes. Being taxes on spending and being spread over a large mass, they would not retard saving or investment and they also would have the potentiality of restricting the total volume of consumption on a scale sufficiently large to ensure release of resources in appreciable quantities for purposes of investment and further development.

25. 5. Practical Difficulties.—While there is little doubt about the principal part indirect taxation must play, the difficulties inherent in controlling consumption—whether through a tax policy or otherwise—in a marginal economy with a teeming population must be fully recognised. It is true that the only means of reducing the inflationary effects of spending would be to create the additional resources required by taxing the consumption of all classes—and inevitably the consumption of the poor. But here the problem of co-ordination will arise. Unless consumption levels are maintained and improved, consumption goods industries will be handicapped by lack of effective demand and industrial development in this direction will be arrested. Again, it is true that, as development proceeds, the incomes in primary sectors will rise and the State will be able to split the increase in part with the primary producers. But, as stated in Para. 24. 3 above, the problem of restricting consumption during the interval does not yield to any easy solution and ultimately it will resolve itself into a question of how much a people on the margin of subsistence will be prepared or can be compelled to sacrifice in the present in return for the promise which the Plan holds out of a more abundant future. Indeed, so many and so vast are the problems—political, social and economic—that are bound to be thrown up by central planning that the prudent course would be to proceed gradually and preserve, subject to general control and as far as possible, the conditions of free enterprise.

Question 26.—How far can tax policy help to promote the efficiency of the productive system? Do you think that multiplicity of taxes in India in respect of the same commodities and their lack of uniformity from State to State affect the allocation of resources in the community and hence the efficiency of the economy? Have you any suggestions for the rationalisation of the country's tax structure in these respects?

26. 1. The Tax System and Productive Efficiency.—A stream of goods and services emerges from the productive system. The rate at which the stream flows, its quantum and continuity determine the efficiency of the system. The tax system impinges at all these points. Its function is negative and in so far as it does not act as a drag on the rate and the quantum and allows continuity to be maintained it may be said to promote productive efficiency.

26. 2. Taxation and Renewal and Replacement of Plant and Machinery.—In the industrial field, the power to produce depends on plant, machinery and equipment, which get worn out and obsolete in time. The efficiency of the productive process is affected unless there is renewal and replacement, and improvement is not possible unless there is expansion and modernization.

Accordingly, a tax policy helps to promote industrial efficiency to the extent it offers inducements through allowances, concessions and exemptions when provision is made for depreciation, or when profits are ploughed back by accumulating reserves, or when new capital is introduced and productive capacity enlarged by extensions and additional installations.

26. 3. Taxation and Capital Formation.—A system also gains in efficiency to the extent it is diversified by the establishment of new productive units. This implies new capital formation and a well sustained velocity of circulation in respect of 'seasoned capital' without which the system tends to rigidity and ossifies. A tax system which offers incentive to savings and capital formation when charging incomes and profits and which does not burden (whether through stamp duties or special taxes like the capital gains tax) the transfer of capital resources to points where they can be most usefully employed contributes greatly to productive efficiency.

26. 4. Indirect Taxes and Productive Efficiency.—The power to produce has meaning only if it results in production. The productive mechanism cannot function unless it has the required raw materials and its products are finally absorbed. The availability and cost of raw materials and the profitable disposal of the end-products are directly influenced by the tax policy pursued. Import and export duties, excise duty, sales tax and other indirect taxes enter into the cost and price structure at various stages and in varying degrees, and unless they are rationalised, the efficiency of the economy is impaired.

26. 5. Cumulative Effect of Multiple Taxation.—A multiplicity of taxes, some of them small in themselves, imposes a cumulative burden, the incidence of which is not fully realised by the individual taxing authorities but which nevertheless impair productive efficiency. The steeply progressive income and super tax, the diversity and heavy rates of stamp duty in different States on purchase, sale and transfer of stocks and shares, the maintenance of export duties irrespective of changed conditions, as in jute and cotton, the varying incidence of State excise duties and cesses, as on coal and sugar, different rates of agricultural income tax as in West Bengal, Madras and Bihar, the diversity of sales tax methods and rates from State to State lead to multiplicity of taxes and lack of uniformity which cannot but impede the smooth and efficient functioning of the economy.

26. 6. The Necessity of Rationalisation.—The Constitution* places a restriction on taxation on inter-State trade. But even otherwise it is most desirable that the tax system should be rationalised. It is therefore necessary that the various Central and State taxes should be listed and classified and their incidence analysed and examined in relation to each other and the system as a whole. Duplication and overlapping, and diversity in policy, procedure, basis of tax liability and rates of taxation, are against the principle of economic cohesion. There is obvious room for centralisation of agricultural income-tax, stamp duty and sales tax in the interests of uniformity and in order to mitigate avoidable hardship to trade and industry. Uniformity in policy, procedure and basis of liability, if not in rates, is also desirable and necessary in respect of other taxes. Rationalisation and co-ordination of taxes and integration of the tax structure on these lines will substantially help to promote the efficiency of the economy considered as a whole. A reform on these lines should not be long delayed.

Question 27.—How far in your view could the tax system be used to secure any order of priorities in the development programme in the private sector?

27. 1. Order of Priorities as between Industries.—The broad pattern of economic development has been sketched in the Five-Year Plan which has charged the private sector with the responsibility for the growth and expansion of industries. The Plan also indicates an order of priority as between different industries.† For example, replacement and modernisation of existing machinery in the case of jute, cotton textiles, sugar, soap and vanaspati are recommended first as not likely to require much capital. The second priority is in respect of producer and capital goods industries like heavy chemicals, iron and steel, aluminium, locomotives, heavy electrical machinery, machine tools, textile machinery, cement, etc. Other industrial units on which considerable capital expenditure has been incurred come next, followed by industries producing key raw materials like sulphur, copper, tin, pulp, etc. The Plan has enumerated positive measures such as financial assistance, foreign exchange facilities and cheap motive power for promoting the given order of priorities and it is in this context that the usefulness of the taxing system should be considered.

* See Part XIII, Article 303.

† See the First Five Year Plan, Ch. XXIX, Paras. 11 to 18.

27. 2. *Channelling the Flow of Investment.*—The main problem, even in the case of consumer goods industries enjoying low priority, is to induce investment in the desired field. As more than 80 per cent. of such investment is earmarked for expansion and modernization of the producer and capital goods industries,* a system of tariffs giving protection according to the order of priority would be of great importance. On this point, the Fiscal Commission makes the following recommendation:

“Tariff protection is now looked upon primarily as a means to an end—as one of the instruments of policy which the State must employ to further the economic development of a country. The protection of industries should be related to an over-all plan of economic development; otherwise there may be unequal distribution of burdens and an unco-ordinated growth of industries.”†

The Fiscal Commission is clearly of the view that protection should be granted on the basis of an over-all plan of development, and now that the Plan has been formulated and approved, it may be expected that effect will be given to the Commission's recommendation.

27. 3. *Further Tax Inducements for Investment.*—Apart from tariffs, further inducements for investment in the desired fields may be given by grant of liberal depreciation allowances and other tax concessions and reliefs as, for example, through a lower corporation tax.

27. 4. *Taxes and Availability of Resources.*—A system of tariffs and taxes geared to the prescribed order of priorities would help to secure closer conformity to the development programme, but that is on the assumption that there are resources available and what is required is a balanced allocation as between the different priority groups. All the same, it also appears that in the very process of channelling the savings, they would exercise a favourable influence on the incentive to invest, which would respond to the prospects of better reward. Thereby, the formation of new capital would be distinctly encouraged.

Question 28.—What are the possibilities and limitations of tax policy as an instrument for economic development (a) by influencing over-all demand, (b) by reducing consumption and unessential investment, (c) by positive inducements for desirable investment, (d) by redistribution of incomes, (e) in other ways?

28. 1. *Influence of Tax Policy on Over-all Demand and Consumption.*—A comparative picture of the group distribution of consumer expenditure in India, the U. K. and the U. S. A. in 1938 appears in Table No. 25. 1. The main trends are confirmed by the National Sample Survey of rural household budgets carried out in July 1949-June 1950, the results of which are also recorded in Table No. 25. 1. The survey discloses that two-thirds of the total expenditure is on food and that clothing and ceremonials each account for approximately a fourth or a fifth of the remaining balance. What is true of the rural areas covering 80 per cent. of the population is essentially true also of the urban working class with perhaps the inclusion of rent as another substantial item. To what extent demand can be influenced by taxation in these circumstances, and how far consumption can be reduced, are questions which presently do not leave any wide scope from the point of view of the development programme. Over-all demand would no doubt increase if employment increases as a result of saving and investment promoted by an appropriate tax policy. The Five Year Plan expects an all-round increase in *per capita* food and cloth consumption in the near future out of the additional incomes created by investment in the five-year period. In the long run, it visualises more diversified demand and consumption when the income is doubled and average consumption standards rise by nearly 75 per cent. at the end of the second decade. The demand schedule and the pattern of consumption will both alter progressively through time and taxation may be directed to keeping them in step with changes in national output. If the expected progressive rise in income materialises, it will create an opportunity for choice, even though it may not connote luxury. Taxation, particularly outlay taxes, may then be used as an instrument to influence the demand and direct it to such points where it does not exert much pressure on available resources. The influence of taxation will partly depend on the distribution pattern of the additional income and on the freedom of choice it creates, but in any case the influence will be limited in that the variation in consumption will be confined to a narrow range of what might be called semi-necessities. Apart from regulation, however, whether taxation can at all succeed in reducing consumption is a matter of considerable doubt, as pointed out in the answer to Question 25 above.

28. 2. *Taxation and its relation to Investment.*—It does not seem that taxation can be usefully employed as an instrument for reducing unessential investment. It has been stated in answer to Question 27 that an

appropriate system of tariffs and tax reliefs may encourage the flow of capital in particular directions by making the prospect more attractive, but it does not lend itself to performing the negative function of checking unessential investment. The positive inducements for desirable investment would not only assist in securing the given order of priorities in the development programme but in the process would also act as an incentive to investment and thereby accelerate the formation of new capital. As the Plan progresses and a larger proportion of the income is devoted to investment, this factor will gain increasing significance.

28. 3. *Taxation and Redistribution of Incomes.*—In an underdeveloped economy, the use of taxation as an instrument of economic development by redistribution of incomes suffers from serious limitations. On the one hand, it operates as a powerful check on saving and investment by groups from whom the incomes are diverted, thereby impeding essential capital formation; on the other hand, it results in distribution of purchasing power over a wide area and among a mass of people on the margin of subsistence, whose saving habits are largely undeveloped and whose claims on larger consumption of what after all constitute necessities are in any case most difficult to resist or control. There is little doubt that taxation is a powerful instrument for redistributing incomes within the community, but whatever its ideological attractions, there is no doubt also that such redistribution in an underdeveloped economy with a large population would only arrest the rate of growth and progress and in no way further economic development.

Question 29.—How would you assess the scope and efficacy of tax policy as compared to monetary policy and direct controls as an instrument of planned economic development in India?

29. 1. *Basic Problem of Planned Economy.*—Planned economic development primarily depends on a high rate of savings and investment. In the view of the Fiscal Commission (1949-50), it is doubtful if in an underdeveloped country like India savings of the large magnitude involved can be raised voluntarily. The Commission points out that the problem of channelling the savings, if effected, will present another organisational difficulty and then expresses itself as follows:

“Consequently, it will be necessary to resort to taxation or rationing of consumption. In a country of India's size and population, where agriculturists dispersed in many thousands of villages account for the bulk of the national consumption, it will be almost impossible to enforce either the taxation or the administrative measures.”*

This constitutes a basic problem in any attempt at planned economic development.

29. 2. *Inadvisability of Physical Controls.*—The Planning Commission suggests that the problem can be met—

“To some extent, by over-all controls through fiscal, monetary and commercial policy which can influence the allocation of resources, but physical controls are also necessary.”†

Physical controls on consumption are however difficult to operate in any country and their usefulness appears to be strictly limited to times of grave national emergency when there is an absolute shortage of goods. For example, in times of war, when the manpower and resources of a country are all monopolised by the State for the one single purpose of waging war against the enemy, production in other directions is cut down to the irreducible minimum and in that context rationing on a national scale becomes inevitable. The coercion and authoritarian measures necessary for the success of such a policy, and the hardships and privations involved, are tolerated in the interests of ultimate survival. War means man-made famine, and the same considerations arise in times of natural famine when it is so widespread and acute as to threaten the existence of the nation. Even in such circumstances, the efficacy of direct physical controls on consumption is constantly undermined by the resistance they provoke and the degree of stress and strain they impose on the sense of discipline and character of the people. The organisational problems they create are also beset by difficulties which not often prove insuperable. When a country is small and the supply of goods can be controlled at the source or point of entry, and when the people enjoy a moderately good standard of life and have developed a high sense of discipline, citizenship and public duty—which is true of the U. K.—, direct physical controls achieve a fair measure of success. Even in such cases, the evils of blackmarketing and corruption gradually appear, and as the emergency wanes and the question of allocation of resources among a large number of alternative uses comes to the forefront, bottlenecks emerge, the productive machine gets clogged up and the economic machine loses its vitality and capacity for adaptation and

* See the First Five Year Plan, Ch. XXIX, Para. 26.

† Report of the Fiscal Commission (1949-50), Book IV, Ch. XII, Para. 159.

* Report of the Fiscal Commission (1949-50), Book III, Ch. IX, Para. 132.

† The First Five Year Plan, Ch. II, Para. 42.

spontaneous growth. In a country like India with a vast area, a huge population and a low standard of living, the problems are multiplied manifold. The sources of supply are not amenable to control. The agriculturist keeps a large portion of the produce for himself and compulsory procurement and levies have to be enforced. The Planning Commission admits that—

“The difficulties of administering an extensive system of controls in an economy organised by and large in small units cannot be under-rated.”*

In fact, the method is far from successful, and when successful, its direct result is to restrict production. Rationing also implies a certain minimum of consumption not always easy to provide when the struggle is on the brink of subsistence. Its inherent difficulties prevent the extension of the system beyond the orbit of the large urban areas or beyond the range of a few big consumers' goods. The partial nature of rationing and controls encourages black markets and problems of administrative organisation and public expenditure become intractable in an environment where the ultimate object of planned economic development is also a distant object to which the mind and spirit of the nation are by no means fully dedicated.

29. 3. *Other Direct Controls.*—Physical quantitative controls on consumption and production do not appear to be suitable instruments for promoting development. But other direct controls, such as regulation of imports and exports and exchange controls are more concentrated in their operation. If well conceived and well administered, they are likely to prove useful aids for husbanding national resources and putting them to the most advantageous use. However, the functioning of these controls is restricted to a limited, if critical, sector of the economy relating to foreign trade and international balance of payments, and they yield the best results when co-ordinated with monetary and fiscal policies which exercise a broad over-all control on the flow and volume of national expenditure, income and investment.

29. 4. *The Instrument of Monetary Policy.*—Monetary policy affects the utilization of resources in the private sector by exercising a dominating influence on the volume of money supply and the general level of prices. The pursuit of a liberal or tight money policy through changes in discount and money rates, the expansion or contraction of the credit base through open market operations, variation in the supply and cost of credit and selective credit control, alteration in reserve ratio requirements and regulation of exchange rates, directly govern the volume of money supply and have a direct impact on borrowing, lending, spending and investment. The Planning Commission recognises that—

“Monetary and credit policy is a powerful weapon for securing the desired result. During the war and in the years immediately following, credit policy as an instrument of over-all control had fallen into the background, but in recent years there has been a general tendency to revive its use.”†

Though monetary policy is a useful tool for furthering economic development, it has its limitations. First, it exercises little restraint on the public sector. Secondly, organised banking plays a relatively smaller part in India than in other countries. This can be seen from Table No. 29. I. The money market in India is not fully integrated and an important sector, largely covering rural areas, which the indigenous bankers and money-lenders continue to dominate, operates outside the organised system. This imposes a limitation on the efficiency of monetary policy as a critical regulator of

the economic system and it has to be combined with a judicious fiscal policy for achieving the best results.

29. 5. *The Instrument of Fiscal Policy.*—Fiscal policy put monetary policy in eclipse during the war and post-war years when it ceased to be solely concerned with questions of revenue collection. The exigencies of war finance and the enormous growth of public debt compelled an increasing resort to the budgetary mechanism and the trend continued thereafter under the sustained pressure of development expenditure. Fiscal measures such as increase or reduction in taxation, the proportion of direct and indirect taxes, changes in the rates and kinds of taxes imposed, a rise or fall in the volume of public expenditure and changes in its direction, surplus or deficit budgeting and the composition of the capital budget have significant repercussions on the economy as a whole and they make fiscal policy a useful instrument of planned economic development. But, as the Planning Commission points out—

“The process of development has always inflationary possibilities, and it is necessary, if development is to be orderly and its incidence not unfair to those classes whose incomes are relatively fixed, that the accent of fiscal policy must throughout be on minimising inflationary pressures.”*

It happens that fiscal policy tends to encourage extravagance in Government expenditure, and when taxation is pushed beyond a point, it starves the private sector by diversion of funds to the public sector. That impedes saving and investment in the private sector and thereby stimulates the same inflationary forces it seeks to control. On the other hand, deficit financing also tends in the same direction and is but a stop-gap device. The main issues have been referred to in some detail in earlier paragraphs and fiscal policy cannot escape these restraints on its usefulness as an instrument of planned economic development.

29. 6. *Judicious Combination of Monetary and Fiscal Policies.*—On the whole, in the circumstances now prevailing, fiscal policy has a wider coverage than monetary policy. But it lacks the mobility, flexibility and refinements of monetary policy, compared to which it is a heavy tool. In most ways monetary and fiscal measures supplement each other, and should they pull in different directions, the effectiveness of both would be largely neutralised. It may therefore be concluded that a judicious combination of monetary and fiscal policies supplemented by discriminating controls on imports and foreign exchange would, if properly co-ordinated, work together as an effective weapon of planned economic development in India. But the Plan is committed to a high level of development expenditure, and it is a question whether, within the framework of a mixed economy and the political system now obtaining in the country, monetary and fiscal measures can restrict consumption and induce saving and investment on a scale commensurate with the rate assumed for generating economic progress. Ultimately, this means that the test is one of the practicability of the Plan itself.

Question 30.—Do you think that the present tax system in India makes for a reduction in inequalities of income and wealth?

30. 1. *Impoverishment is not Reduction of Inequalities.*—The various aspects of the present tax system from the point of view of inequalities of income and wealth have been dealt with in the foregoing paragraphs, particularly in answer to Questions 1 to 6 and 12 to 16. Essentially, the problem is one of a relatively backward economy supporting an extraordinarily large population of 360 million, of whom an overwhelming majority lives on the bare margin of subsistence. A fractional proportion of the population enjoys what might be called a reasonably fair standard of living and the percentage of those with large incomes or wealth is infinitesimally small. In the circumstances, the redistribution of income and wealth through drastic taxation of those above the minimum level only results in general impoverishment by attempting to pull down everybody to the same low average level of income and wealth.

30. 2. *Tests of the Efficacy of a Tax System.*—There are two tests that can be applied for judging the efficacy of a tax system in bridging inequalities of income and wealth. In highly advanced economies, taxation of incomes and profits covers a large section of the total population† and therefore the transfer of resources adds substantially to the income of those below. Inequalities are thereby reduced. By and large, this is true of the U. K. tax system, though even there the present trend is to reduce the tax burden because of its strong disincentives on productive enterprise. The tax system can bring about reduction in inequalities, not only by subtractions of income and wealth from those above so as to leave their possessors with a smaller residue, but also by adding from below by creating conditions in which there is rapid economic development improving the general standard of living of the masses. It is this

TABLE NO. 29. I
(Year : 1948)

Country	Total Bank Deposits 1,000 Mn.	National Income 1,000 Mn.	Bank Deposits as Percentage of National Income
	Rs.	Rs.	%
U. S. A.	472.7	737.5	64
Canada	26.5	41.6	64
U. K.	82.7	137.4	60
South Africa	5.1	11.1	46
New Zealand	2.0	4.5	44
Australia	8.4	20.7	41
Japan (1949)	7.7	26.5	29
India	9.6	87.3	11

(Source : Reserve Bank of India Report on Currency and Finance, 1949-50, Statement 4, p. 120, and Question 1 above, Table No. 1-I)

* The First Five Year Plan, Ch. II, Para. 44.

† The First Five Year Plan, Ch. II, Para. 27.

* The First Five Year Plan, Ch. II, Para. 31.

† See Table No. 1, III.

broader test that holds for the taxation system of under-developed countries like India, afflicted with chronic problems of poverty, unemployment and underemployment. In such cases, inequalities can only be diminished by adding from below. The emphasis must accordingly lie in quickening the rate of economic development so that the size of the national income increases substantially, providing a higher per capita income and an opportunity for all to enjoy a better standard of living. Heavy taxes on incomes and profits reduce the capacity to save and the incentive to invest, and thereby retard economic growth and expansion and perpetuating the low standards of living.

30. 3. Defects of the Present Tax System.—The present system of taxation in India falls short of measure by both these tests. It tends to make the rich poor but it does not make the poor rich. Equality of poverty has no economic value. In attempting to reduce inequalities of income and wealth, the Indian tax system only succeeds in impeding capital formation and tends to reduce that rapid growth of income and wealth without which, in terms of the present economic and political order, there is no springboard for an escape from the cycle of poverty and unemployment perpetuating unemployment and poverty.

Question 31.—*What modifications in the tax system would you suggest for securing a larger degree of economic equality, consistently with maintaining the incentives to capital formation and higher production?*

31. 1. Shift in Taxation.—The incidence of taxation on various classes of people in relation to their income and contribution to economic development has been discussed in the foregoing paragraphs, particularly in answer to Questions 2 to 6 and 12 to 14 above. The middle class has been the principal sufferer in the inflationary conditions obtaining in war and post-war years, and the upper class has also been penalised, though not as severely. The terms of trade have moved heavily in favour of agricultural classes and industrial labour, both of whom are relatively much better off. A shift from direct to indirect taxation and from urban to rural taxation would, therefore, be in accordance with economic considerations and would be besides not inequitable. At the same time, such a change-over would provide much needed relief to classes which have a well developed saving and investment habit combined with a capacity for engendering progress by organisation and technical skill.

31. 2. The Importance of Encouraging Capital Formation.—Capital formation and higher production would also be encouraged by granting exemptions to new industries and industrial units, by enlarging tax concessions and allowances in respect of depreciation, renewal and replacement and by reducing the corporation tax. Shortage of capital not only curtails employment opportunities; it also adversely affects the productivity of industry and labour and depresses the real earnings of those who are employed. A sustained rise in productivity is to the advantage of all. It gives to labour an improved standard of real wages, to the investor a higher return on his savings and to the consumer better value for his money. Greater employment and earning opportunities, higher wage rates and better yields which result from the establishment of new productive units and from the proper maintenance and expansion of existing equipment would make for a larger degree of economic equality. Accordingly, the tax system should be modified to provide for lighter taxes on corporation profits and a more flexible system of depreciation and replacement allowances, for example on the lines of the recommendations made by the Millard Tucker Committee and the practice followed in countries like France.

31. 3. Increased Capital Formation and Productivity Pre-conditions of Economic Equality.—Whatever the field of activity, agricultural or industrial, it seems highly desirable that the emphasis should fall on capital formation and increased productivity as essential conditions precedent to securing a larger degree of economic equality. High productivity, whether in agriculture or industry, is the main key to a high standard of living. Table No. 31. I setting out estimates of productivity in

TABLE NO. 31. I

Region	Percentage of World Industrial Output Produced by 10 Mn. people %	Industrial Production per Head of Population Index
Asia, Africa and Latin America	·056	100
Pacific—Japan, Australia and New Zealand.	·330	589
Eastern Europe	·833	1,488
Western Europe	·960	1,714
North America	2·294	4,096

industry in various regions of the world shows the range and scope of possible improvements in an under-developed country like India. Productivity is mostly, though not always, related to capital equipment.* It has been computed that in the U. S. A. the gross value of product per wage earner has risen seven to eight times between 1850 and 1940, more or less in proportion to the capital investment which over the period has risen ten to twelve times. As Table No. 31. II shows, productivity per man-hour, the level of wages and national income standards are in close correlation with the level of capital intensity at which an economy is operating. It is not wrong to say that productivity is one of the basic factors drawing down Indian per capita income. The dynamic element of capital formation is the means by which productivity can be substantially improved from

TABLE NO. 31. II

Countries	Per capita Income \$	Industrial Investment per Worker Index
Developed	461	100
Intermediate	154	39
Under-developed	41	11

(Source: U. S. A. State Dept. Publication—Point Four—1949)

its present low levels, accelerating the rise in per capita income and strengthening the capacity to produce a larger national income. Hence the emphasis of the Planning Commission that—

“The key to higher productivity and expanding levels of income and employment lies really in stepping up the rate of capital formation.”†

In an under-developed country like India, the pursuit of economic equality tends to be at the cost of capital formation which in its turn hits productivity. But “unless productivity is improved”, as Prof. Kenneth H. Parsons points out in his Report to the Planning Commission, a movement to eliminate inequalities in present-day India will end only in “equality of poverty”.‡

Question 32.—*What place would you assign to public expenditure as compared with the tax system in achieving a greater measure of equality of income?*

32. 1. The Relative Place of Taxation and Public Expenditure.—As stated in answer to Question 1 above, in terms of the principle of maximum social advantage, economic welfare depends primarily on improvements in productive power and then on the distribution of what is produced. Improved distribution implies more equal distribution between different individuals and families. Taxation reduces disparity negatively by subtraction from above, directly reducing the quantum of disposable income. Public expenditure reduces disparity positively from below, directly reducing the expenses which have to be incurred. The economic advantage of taxation and public expenditure depends entirely on how the money is raised and on how it is spent. In a substantial measure, taxation and public expenditure are complementary, but not always so. Not all the revenue is utilised for public expenditure; there may be surplus budgeting. Similarly, not all the public expenditure is met out of taxation; there may be borrowing or deficit financing. Accordingly, the incidence of taxation or public expenditure on distribution is only a part of the wider question of effects which have an over-riding importance in any final analysis.

32. 2. Taxation and Equality.—A greater measure of equality has significance from the point of view of maximum social advantage only if it results in better distribution of what is produced. Considering the distribution aspect in isolation, a tax system which resorts to heavy taxation reduces inequalities of income but does not contribute directly to better production. A rich man with more taxes to pay may pay them, not by cutting down consumption, but out of what he might have otherwise saved and invested. A poor man with no direct taxes to pay is not much better off, as his total income is relatively inadequate for his needs, and when the taxes are indirect, it is his consumption that is taxed and no question of relief arises. As a consequence, there is little real gain, though apparently a greater measure of equality of income is achieved.

32. 3. Public Expenditure and Equality.—The incidence of public spending is directly in relation to those who receive the benefit from such spending. It can be regulated so as to result in special benefits to

* See the First Five Year Plan, Ch. I, Paras. 16 and 17.

† The First Five Year Plan, Ch. I, Para. 15.

‡ Parsons, Report on Land Reforms submitted to the Planning Commission.

particular members of the community, or in general benefit to all members, or in a mixture of the two. A large field is open for intervention through improvement in economic provisions for the future and restoration of better balance between the component elements of society according to needs and wants. In this category falls expenditure on such worthwhile objects as education, health, housing, old age pensions, sickness and unemployment insurance, poor relief and similar other benefits which add to productive efficiency and contribute directly to social well-being. Such distribution of resources as between different groups, objects, needs and localities through the medium of public expenditure constitutes a real gain in welfare, though apparently equality of income is not achieved. It is however necessary to remember that only a small portion of the public expenditure is in this direction, and that the costs of public administration, apart from the corruption and inefficiency involved, are not infrequently excessive in relation to the results obtained.

32. 4. Inter-relation between Taxation and Public Expenditure.—It has been pointed out above as well as in answer to Question 16 that taxation and public expenditure are closely inter-related. For instance, no matter how desirable public expenditure may be, it may be worthwhile incurring it if the money is raised by one scheme of taxation and not if it is raised by another. Public expenditure has its limits not only in respect of the amount that can be advantageously spent so as to produce equimarginal social advantage in all directions; it cannot be carried beyond the point when it is outbalanced by the marginal social disadvantages of the various methods of raising additional resources, whether through taxation, borrowing or deficit financing. And in any case, neither the distribution effects of taxation nor of public spending in achieving a greater measure of equality can be considered in isolation by themselves without taking into account all the other effects, especially those on productive power, which are of primary and predominant importance in any evaluation of the maximum social advantage.

Question 33.—Have you any changes to recommend in tax policy in relation to the investment of foreign capital in India?

33. 1. Foreign Capital Desirable.—It has been emphasised in the foregoing paragraphs, particularly in answer to Questions 18, 20, 24 and 25 that the volume of internal savings sets rigid limits to the economic development of an under-developed country like India and that foreign capital is necessary to ease the strain on domestic resources. The Fiscal Commission says—

“We are doubtful whether during the next three or four years India will be able to secure, by internal savings, the order of capital needed for its requirements. The need for foreign capital thus becomes apparent.”*

These doubts appear to have been well founded. Further, the development plan contemplates large expenditure on capital goods and equipment to be imported from abroad. External assistance, if available, would serve the dual purpose of making available adequate supplies of foreign exchange and at the same time supplementing the investible resources in the country.† The Planning Commission therefore advises that—

“External resources at strategic points and stages can be of so much assistance in a period of rapid development that it is desirable, consistently with other objects, to create conditions favourable to this inflow.”‡

33. 2. Penal Taxation Undesirable.—To promote an ample flow of capital, it is necessary that the tax policy should be so devised as not to impose a penalty on foreign investors or discriminate against them. For example, the International Chamber of Commerce prescribes the following two Articles among other reasonable requirements for recreating conditions in which capital and skill flow across political boundaries to territories where they can be most advantageously employed:

“The High Contracting Parties shall not give less favourable treatment in respect of taxation to nationals of the other High Contracting Parties than to their own nationals.

In order to eliminate the serious deterrents to the development of foreign investments resulting from double taxation, the High Contracting Parties shall seek to conclude bilateral agreements for the prevention of the double taxation of income, and of capital, estates and succession on the basis of the two Model Bilateral Conventions of London drawn up for that purpose by the League of Nations.”§

33. 3. Taxation and Return on Foreign Capital.—It is not enough to provide for non-discrimination against

foreign capital. If there is to be a flow of international investment on an adequate scale, there must first be created a climate of confidence and stability with opportunities of earning a fair return on capital. On this point, the Income-tax Investigation Commission observes:

“If Indian opinion and the Indian Government desire to invite foreign capital and foreign business, liability to tax is an important factor for the foreign investor to consider before deciding whether he should invest money in India or not.”*

Accordingly, to the extent to which the country is interested in encouraging foreign investments, it should consider the adoption of domestic policies which stimulate the formation of new capital. As the International Chamber of Commerce points out—

“Such policies include, most of all, measures in the field of taxation. Taxation inherited from the war remains so high in the countries concerned as to become a genuine obstacle to formation of capital.”†

The tax policy that should be pursued for speeding up domestic capital formation has been outlined in the answers to Questions 20 to 22 above. If made effective, such a policy will not only accelerate, as the Fiscal Commission recommends,‡ a concentrated development of the country's internal resources but will also create conditions favourable to the inflow of foreign capital. Dealing with this point, the Planning Commission says—

“The rate of return to capital in some of the industrially advanced countries is higher than that obtainable in India. In view of all these considerations, it is of the highest importance to ensure to the foreign investor the prospects of fairly good return and the certainty of fair and equitable treatment.”§

It is, however, necessary to add that, ultimately, foreign capital venturing into this country must retain its character as risk capital and it is not entitled to any special tax concessions which are not equally available to domestic capital.

Question 34.—Article 269 of the Constitution enumerates the following taxes which may be levied and collected by the Union but the proceeds of which are to be assigned to the States: (a) duties in respect of succession to property other than agricultural land; (b) estate duty in respect of property other than agricultural land; (c) terminal taxes on goods or passengers carried by railway, sea or air; (d) taxes on railway fares and freights; (e) taxes other than stamp duties on transactions in stock exchanges and future markets; (f) taxes on the sale or purchase of newspapers and on advertisements published therein.

How do you assess the possibilities of adding to the country's tax resources in respect of the above items?

34. 1. Taxes under Article 269 undesirable.—The taxes enumerated in Article 269 do not seem to be capable of adding appreciably to the country's resources. In fact, some of them will lead to multiple taxation of income and capital and can do much harm. For example, on the subject of taxes on fares and freights, the U. N. Public Finance Survey of India (1951) makes the following comment:

“Taxes on the movement of goods and persons are perhaps the most serious example of jurisdictional overlapping as between the Central Government and the States, because they have traditionally been an important source of revenue in India. In recent years, indeed, they have tended to decline in importance, largely as the result of a realisation of their bad effects on inter-State and even international trading; it is to be feared, however, that they are now on the increase again in view of the revenue pressure which has developed.”||

It may be added that taxes on fares and freights can only lead to cost inflation and that any taxes on the sale and purchase of newspapers is tantamount to a tax on democracy.

34. 2. Estate and Succession Duties.—Estate Duty has been already imposed by the Centre, and both, succession duties and estate duties, are in the nature of a levy on capital. Whatever their other justification, these duties are likely to lead to sequestration and dissipation of usefully employed accumulated resources. If the exemption limits are low and the rates of duty are high, as they are in the case of Estate Duty, they are likely to have an adverse effect on investment and capital

* Report of the Income-tax Investigation Commission (1949), Sec. IV, Para. 29.

† I. C. I. Brochure on “Financing Economic Development”, Sec. IV, p. 13.

‡ Report of the Fiscal Commission (1948-49), Book V, Ch. XVI, Para. 222.

§ The First Five Year Plan, Ch. XXIX, Para. 78.

|| U. N. Public Finance Surveys—India (1951), Ch. VI, p. 69.

* Report of the Fiscal Commission (1949-50), Book V, Ch. XV, Para. 220.

† See The First Five Year Plan, Ch. III, Para. 43.

‡ The First Five Year Plan, Ch. I, Para. 44.

§ I. C. I. International Code of Fair Investment for Foreign Capital, Articles 7 and 8.

formation. It has been doubted whether such taxes could be made into "equitable and avoidance-proof levies". They are not easy to implement, and considering the costs of administration, their net yield to the exchequer will tend to be small and their general effects disadvantageous at this backward stage of the country's economic development.

34. 3. No Scope for Taxes on Forward Transactions.—There is no scope at all for imposing taxes, other than stamp duties, on transactions on Stock Exchanges and in futures markets. The high incidence of taxation in relation to stock markets has been referred to in the answer to Question 17 above where it has been shown how heavily the tax burden weighs particularly on this occupation. The subject is further dealt with in some detail in the answers to Questions 162 and 163 in Part V. The conclusion there reached is reiterated—namely, that the burden should be drastically reduced if the stock market is to survive as a useful unit and perform its proper function in the economy of the country.

Question 35.—Other possible ways of adding to tax receipts which have been suggested are taxes on capital, reintroduction of the salt duty, surcharges on land revenue, betterment levies, agricultural income-tax, social security taxes and modification of the policy of prohibition having regard to the directive principles of the Constitution. What are your views regarding the desirability and the probable scope of each of these forms of taxation?

35. 1. Taxes on Capital Undesirable.—At a time when the main stress and emphasis is on capital formation as the key to quick economic development, taxes on capital which directly reduce the volume of savings and investment cannot be deemed to be either desirable or feasible.

35. 2. Salt Duty.—The arguments for and against re-introduction of the salt duty are fairly simple. Because of its associations with the struggle for freedom, the abolition of salt duty has a strong political appeal. From the economic point of view, the question has been stated as under by Sir Josiah Stamp in his reply to the Indian Taxation Enquiry Committee (1924-25):

"I should work out the tax burden on a low income (*via* salt) and ask, if abolished, or altered, in what probable respects well-being would be improved by the ordinary exercise of the improved purchasing power. If inconsiderable, I would continue the burden."

In view of the war and post-war shifts in incomes and general rise in prices, it can scarcely be argued that the absence of the salt duty either improves the purchasing power and standard of living of the masses or otherwise increases their margin of savings. As can be seen from Table 35. I, the duty used to bring in a fair yield before it was abolished. Its re-introduction, therefore, appears

* Report of the Indian Taxation Enquiry Committee, Ch. VII, Para. 164.

to be desirable, as it would easily produce a revenue of Rs. 10 to Rs. 15 crores and its incidence per head would not exceed a few annas.

TABLE NO. 35. I

Year	Salt Duty in Crores of Rs.	Year	Salt Duty in Crores of Rs.
1900-01	8.4	1940-41	7.7
1913-14	4.7	1941-42	9.2
1920-21	5.8	1942-43	10.9
1929-30	6.5	1943-44	8.3
1938-39	8.1	1944-45	9.3
1939-40	10.9	1945-46	10.2

(Source : Budgets of the Central Government.)

35. 3. Land Revenue.—As pointed out in the answer to Questions 13 and 14 above, land revenue because of its fixed base and insensitivity to changing conditions has remained static in quantity over a period of revolutionary change and its contribution to the total Part A States revenue has declined from 43.1 per cent. in 1938-39 to about 18.3 in 1952-53. It has been observed that the present pattern of taxation in Part B States corresponds more closely to the pre-war than to the present tax structure of Part A States and because of that Part B States have a higher *per capita* revenue. The Finance Commission (1952) reports this fact as under:

"The *per capita* tax revenue collected by the States (i.e., excluding the share of income-tax) in 1951-52 is Rs. 6.6 for all States, the average for Part B States is higher at Rs. 9 and no Part B State is below the average for all States together

The *per capita* revenue of Part B States which, as already noted above, is definitely higher on the whole than of Part A States, is higher under the older taxes like land revenue and excise, particularly the latter."

This is borne out by Table No. 35. II giving the *per capita* revenue from the principal sources of income for 1950-51 and 1951-52 of three Part A and three Part B States enjoying the highest *per capita* income. It can be seen that Saurashtra has a high total *per capita* income in spite of prohibition chiefly because of the high yield

* Report of the Finance Commission (1952), Ch. III, Paras. 43 and 45.

TABLE NO. 35. II

(Per capita Revenue in Rs.)

States	1950-51				1951-52			
	Land Revenue	Excise	Sales Tax	Total	Land Revenue	Excise	Sales Tax	Total
Part A :—								
Bombay	1.8	0.3	4.2	10.0	1.7	0.3	3.6	9.1
West Bengal	.9	2.5	2.5	8.7	0.8	2.7	2.8	9.4
Madras	1.2	0.1	2.9	6.5	1.6	0.1	3.0	6.7
Part B :—								
PEPSU	2.8	5.4	1.4	10.7	2.6	6.7	1.3	12.3
Hyderabad	2.4	5.2	0.4	10.2	2.6	5.1	1.0	11.0
Saurashtra	5.1	0.4	0.2	8.6	3.7	0.4	0.7	7.1

(Source : Report of the Finance Commission, 1952. App. IX, Table 6 (a), pp. 174-75.)

under land revenue. The inference that should be drawn is recorded by the Planning Commission in the following terms:

"In countries which are largely agricultural, and in which transactions involving money are a smaller proportion than in more industrialised systems, land has been traditionally an important basis for taxation. In Japan, when its programme of industrialisation was being introduced in the 1870's, taxation of land yielded as much as 13 per cent. of the value of gross agricultural produce; even thirty years later, when other forms of taxation had developed,

land tax accounted for nearly half of the total tax revenue of the government In the last decade, prices have moved in favour of primary commodities and since in most parts of the country land revenue has not been revised upwards, the burden of the tax has been considerably lightened . . . there is a case for a moderate upward revision of land revenue."

Political considerations apart, the imposition of a surcharge on land revenue would bring in a larger yield,

* The First Five Year Plan, Ch. III, Para. 12.

but that would not solve the principal issue of a thoroughgoing revision of the basic levy in the light of the circumstances now prevailing.

35. 4. Betterment Levies.—Betterment levies have been suggested by the Fiscal Commission (1949-50)* and the Planning Commission† but it seems doubtful whether an equitable and scientific system can be devised for assessing the unearned increments in the value of land or other property, and whether such increments can be subjected to tax without imposing undue hardship. As Prof. Pigon observes:

“In actual life, however, apart from the services which an occupying owner derives from his house, it is generally held that only that part of real income, which has a money counterpart, can be brought into account; to bring in other parts would involve such high administration costs as not to be worthwhile.”‡

Instead of such special levies which may tend to become inequitable and prove unnecessarily burdensome, the more appropriate and satisfactory procedure would be to revise the land revenue and property taxes as suggested in Para. 35. 3 above.

35. 5. Agricultural Income-tax.—Agricultural income-tax is already in operation in several States but it brings in a very small revenue equal to about 1 per cent. of the State revenues compared to the contribution of non-agricultural income-tax which amounts to as much as 40 per cent. of the total Central revenue. In view of the recent shifts in income and general rise in prices, it seems desirable and necessary that the potentialities of agricultural income-tax should be more fully explored. Its operation should be extended to States where it is still not being levied and the tax should be collected on a national scale from the Centre at uniform rates.

35. 6. Social Security Taxes.—As pointed out in answer to Question 16 above, there appears to be good scope for effecting economies and reducing what might be called negative public expenditure. In the present state of development, instead of imposing special security taxes, such as provident fund and employees' health insurance contributions which add to the burden on industry and curtail opportunities of larger employment, it would be better to rationalise public expenditure and utilize the savings for measures of social security, which form as much a part of the ordinary activity of the State as maintenance of law and order.

35. 7. Modification of the Policy of Prohibition.—The introduction of prohibition is one of the directive principles of the Constitution.§ It is also said to command public support. However, as long ago as 1924-25,

* See the Report of the Fiscal Commission (1949-50), Book V, Ch. XV, Para. 212.

† See the First Five Year Plan, Ch. III, Para. 12.

‡ Pigon, Study in Public Finance, pp. 77-78.

§ See Part IV, Article 37.

the Indian Taxation Enquiry Committee made the following observation which is substantially true today:

“The Committee have expressed the opinion that a policy of real prohibition would involve a loss of revenue exceeding the return from any new proposals that can be put forward.”*

This is evident from Table No. 35. II, which shows that Part B States have a larger *per capita* revenue than Part A States in spite of Part A States having in their tax-structure “more new elements than the tax systems of the Part B States”.† The *per capita* tax revenues of PEPSU and Hyderabad are higher than those of Bombay and West Bengal entirely because of larger excise revenues. As the Finance Commission explains—

“The *per capita* revenue of Part B States which, as already noted above, is definitely higher than those of Part A States, is higher under the older taxes like land revenue and excise, particularly the latter. In respect of excise, the *per capita* revenue of Hyderabad is more than double that of the next highest State, *viz.*, West Bengal.”‡

The steep fall in revenue under this head in respect of States adhering to the policy of Prohibition has also been noticed in the answer to Question 14 above and the relative change in position is described in the U. N. Public Finance Survey of India as under:

“In Madras, the United Provinces, Bombay, Bengal and Bihar, liquor excises used to be a major source of revenue, rapidly expanding during the war, and in Madras, for instance, providing a revenue double that of land revenue in 1947-48. Madras went completely dry in October 1948, Bombay in April 1950. In the United Provinces which have not followed so complete a prohibition policy, excise revenue has declined by Rs. 1 crore, but is still important. In Bihar, the decline is not serious, while in Bengal excise revenue actually rose from Rs. 3.55 crores in 1947-48 to Rs. 5.97 crores in 1949-50. Elsewhere the march of prohibition has been completely slowed down or even completely halted.”§

To the loss of large excise revenue have been added other costs. The costs of enforcement in money terms are reflected in the unbalanced public expenditure to which a reference has been made in the answer to Question 16 above. They can also be inferred from Table No. 35. III, which shows the large expenditure on police forces by States with prohibition, like Bombay, though they have little political or security trouble of the kind facing Bengal, Punjab or Hyderabad. In fact,

* Report of the Indian Income-tax Enquiry Committee (1924-25), Ch. XV, Para. 498.

† See Report of the Finance Commission (1952), Ch. III, Para. 45.

‡ Report of the Finance Commission (1952), Ch. III, Para. 45.

§ U. N. Public Finance Surveys—India, 1951, Ch. VI, p. 73.

TABLE NO. 35. III

State	State Expenditure on Police			
	Total in Crores of Rs.		Per capita in Rs.	
	1950-51	1951-52	1950-51	1951-52
Part A :—				
Bombay	9.12	9.33	2.5	2.6
Bengal	5.30	5.76	2.1	2.3
Punjab	2.65	2.68	2.1	2.1
Madras	6.99	7.17	1.2	1.3
U. P.	7.41	7.29	1.2	1.2
M. P.	2.52	2.47	1.2	1.2
Assam	0.86	0.96	1.0	1.1
Bihar	3.90	4.09	1.0	1.0
Orissa	1.36	1.37	0.9	0.9
Part B :—				
Saurashtra	1.03	1.17	2.5	2.9
Hyderabad	4.84	5.19	2.6	2.8
PEPSU	0.67	0.76	1.9	2.2
M. B.	1.51	1.59	1.9	2.0
Rajasthan	2.18	2.34	1.4	1.5
Mysore	0.85	0.89	0.9	1.0
Travancore-Cochin	0.61	0.65	0.7	0.7
TOTAL	51.80	53.71	1.5	1.5

the total as well as *per capita* expenditure on police is among the highest in Bombay and has been steadily mounting up from year to year. This is apparent from Table No. 35. IV (page 16). Side by side this increasing burden of negative expenditure is the increasing public disregard for law and the growth of corruption. While

TABLE NO. 35. IV

Year	Bombay State Expenditure on Police		
	Total in	Per Capita	Index
	Crores of Rs.	Rs.	(1948-49= 100)
1948-49	7.04	1.9	100
1949-50	8.43	2.3	120
1950-51	9.12	2.5	130
1951-52	9.33	2.6	133

(Source: Report of the Finance Commission, 1952, Appendix IX, Table 11, p. 194.)

citing the good performance of Bombay in other Departments, Dean Paul H. Appleby points out that—

“There a principal source of corruption remains in prohibition enforcement.”*

These repercussions of the policy of prohibition have caused apprehension. The U. N. Public Finance Survey of India therefore makes the following comment:

“The State of Madras went wholly dry in October 1948, Bombay followed in April 1950. Owing to the revenue importance of liquor duties, a policy so disruptive of State finances, and thus ultimately a danger to central finances also, is now viewed with a certain amount of apprehension by the Central Government, and pressure to extend the dry area is no longer coming from the Centre.”**

Apart from financial considerations, the success of the prohibition policy is thus being increasingly doubted, particularly in the light of foreign and current domestic experience. In any case, it is far from obvious whether, of all the numerous aims and objects listed in the Directive Principles of the Constitution, the one on prohibition must necessarily take the highest priority. It is significant that Article 47 (like Articles 43, 44, 45, 48 and 51) requires only that “the State shall endeavour to bring about prohibition”, whereas in a number of other Articles the injunction is not merely exhortative but mandatory, as, for example, in Articles 39 to 42, 46, 49 and 50 providing for such matters as means of livelihood, health, education, public assistance in cases of unemployment, old age, sickness and disablement, etc. This distinction between the two sets of Articles must be accepted as a guide to priorities when framing policy on the basis of the Directive Principles. It follows, therefore, that the policy of prohibition should be suitably modified.

Question 36.—Do you consider it desirable and feasible to levy a tax on unearned increments in value of land and other property as a result of public projects of development?

36. 1. The question has been dealt with in Para. 35. 4.

Question 37.—What measures would you suggest for increasing the receipts from existing sources of revenue?

37. 1. *Revision of Rates and Approach likely to Increase Tax Receipts.*—It has been repeatedly observed in the foregoing paragraphs that direct taxes on income and profits appear to have passed the point of diminishing returns. It has also been suggested that the rates should be scaled down and that the tax burden should be redistributed among various classes and various kinds of taxes. Revenue is likely to improve in response to such changes. The receipts would also increase if, as can be gathered from the answer to Question 15, there is a radical transformation in the approach and attitude of the tax collecting authorities. As the Income-tax Investigation Commission recommends—

“The Income-tax Officer must show by his conduct that he is not the tax grabber he is described to be but a referee standing between the State on the one hand and the tax-payer on the other, with the sole idea and desire that both get a square deal. If the Income-tax Officer sees to it that he is regular in attendance, prompt in attention, courteous in listening to grievances, however frivolous, in the

manner of a skillful salesman, he will immediately find an encouraging response from the tax-payer.”*

Co-operation with the public on these lines by all taxing departments is much to be desired from the point of view of better revenue and more friendly relations.

37. 2. *Necessity of Improving Efficiency.*—Receipts from existing sources of revenue can also be improved by gearing up the administrative machinery to the pitch of efficiency and economy. Elaborate legislation, red tape and duplication exercise a depressing influence on yield. A streamlined administration trained in up-to-date methods would appreciably increase the revenue derived, for example, from income-tax and sales tax. Modernisation and rationalisation of Government Departments may be said to have become long over-due, but it is a matter of doubt whether any thoroughgoing reform is feasible in the light of the conditions now obtaining.

Question 38.—What other new sources of taxation can you recommend?

38. 1. The question has been dealt with in the foregoing paragraphs, particularly in the answer to Question 19.

Question 39.—To what extent and as regards what taxes should the powers of the Centre to impose surcharges under Article 271 of the Constitution be used?

39. 1. *Surcharge—An Exceptional Measure.*—A surcharge implies an addition to the normal charge and should accordingly be imposed only in exceptional circumstances. When the additional tax is meant to be temporary and specifically levied for the duration of an emergency, it may take the form of a surcharge. But a permanent surcharge, for example, the 50 per cent. surcharge on stamp duty in the Bombay State, has no meaning or justification. It only seeks to camouflage the real nature of the burden by breaking it up into two parts so that neither part by itself may *prima facie* seem excessive. Such deception cannot continue for long and only ends in administrative complications without any sensible advantage.

39. 2. *When should Surcharge be Levied.*—So far as the Centre is concerned, the surcharge has another meaning beyond the symbolical one conveying its temporary character. When the tax concerned is divisible between the Centre and the States, the surcharge does not form a part of the common pool but becomes a part of the Consolidated Fund of India exclusively earmarked for the Centre. As such, it is an important instrument wherewith the Centre can increase its share out of the proceeds of a given tax without any alteration in the prescribed percentage share allocated to the various States. Such circumvention by the Centre of the prescribed percentage fixed by an independent body like the Finance Commission can only be justified in times of an emergency like that of war, when the Centre has to shoulder special extra expenditure, very little of which is required to be borne by the States. In such circumstances, the surcharge is best imposed on taxes which are derived from sources benefiting most from the increased expenditure of the Central Government, or from which the yield can be increased by interception of windfall gains attributable to the extraordinary circumstances.

39. 3. *Conclusion.*—It follows from the foregoing that the Centre should impose a surcharge under Article 271 of the Constitution only when the additional tax is of a purely temporary character designed to meet an emergency or special situation involving the Centre in large additional expenditure, that the surcharge should be in respect of taxes divisible between the Centre and the States, and that it should be removed as soon as the extraordinary circumstances cease to exist or to exercise a significant influence. There is no occasion for Government to levy surcharges in normal times and accordingly such surcharges where they survive at present should be abolished forthwith.

Question 40.—What are the scope and limitations of tax policy as an instrument for dealing with inflationary or deflationary situations in Indian conditions?

40. 1. *Factors Governing Influence of Taxation on Inflationary and Deflationary Situations.*—The nature and extent of the influence which taxation exercises over inflationary and deflationary situations depend on—

- (a) the proportion which public income and expenditure bear to the aggregate national income and expenditure;
- (b) the quantum of public expenditure, its nature and distribution between essential, productive, social and other heads;
- (c) the *per capita* income which ultimately bears the taxes; and
- (d) the coverage of taxes over different groups, and the kinds of taxes and their distribution between various sectors of the economy.

* Report of the Income-tax Investigation Commission, 1949, Recommendation No. 189, p. 243.

* Appleby Public Administration in India—Report of a Survey, 1953, Sec. VI, p. 49.

** U. N. Public Finance Surveys—India, 1951, Ch. II, p. 15.

It is apparent that the higher the proportion of taxes to the aggregate national income and the smaller the percentage of the essential to other public expenditure, the greater is the field of manoeuvrability. In deflationary situations, taxes can then be reduced sufficiently to leave incomes in the hands of individuals on a scale large enough to revive effective demand and stimulate economic activity. Conversely, in inflationary situations, non-essential public expenditure can be curtailed and taxes can be pitched up to the extent necessary for siphoning off the surplus purchasing power pressing against the available supply of goods and services. By the same token, the higher the *per capita* income, the larger the coverage of taxes and the wider their distribution, the greater is the capacity of the tax system for correcting inflationary and deflationary situations.

40. 2. Limiting Factors in Indian Conditions.—It has been pointed out in answer to Question 1 above that, in India, the proportion which public revenue and expenditure bear to the aggregate national income and expenditure is extremely low, being about 8 per cent. as compared with 25 per cent. in the U. S. A. and Canada and 30 to 40 per cent. in Australia and the U. K. Likewise, the bulk of the public expenditure is of limited variety and relatively inelastic, the *per capita* income of Rs. 255 is among the lowest in the world, the coverage of direct taxes constituting 30 to 40 per cent. of the total revenue is limited to less than one-fourth of one per cent. of the entire population, and the yield of other taxes is far too poor in relation to the size of the population numbering 360 millions. These factors fix close critical limits in either direction within which taxation can be used as a weapon for controlling inflation or deflation. When these limits are exceeded, the tax system tends to aggravate the maladjustments it sets out to rectify.

40. 3. Consequences of Excessive Reliance on Taxation.—It may be accepted that if taxes were the only alternative to inflation and deflation, they would be the more desirable alternative. It is easier to bear a rationally planned equitable tax schedule than to suffer the inequities of a tax levied by reducing and raising the purchasing power of a currency. But taxes are not the only alternative, and in an under-developed country like India which has embarked on a plan of rapid development, they do not take long to approach the limit of what the economy can bear when the spending is too great. In such cases, the inflationary effects of a high scale of Government expenditure are not neutralised by heavy taxation. On the contrary, as Colin Clark observes—

“The part that excessively high taxes play in causing inflation is not fully appreciated. It is widely understood that if a Government incurs very heavy expenditure, and these are not covered by taxation, and the Government runs at a deficit, the automatic result will be an inflationary trend. It is not so generally understood that if a Government incurs very heavy expenditures, and these are covered by taxation, so that the budget is balanced, the trend—while it may be deflationary for a time—will in the long run be towards inflation if the rate of taxation is too high to be borne.”

Colin Clark suggests that “25 per cent. of the national income is about the limit for taxation in any non-totalitarian community in times of peace” and in his Capper Moore lecture he has expressed the view that in the case of under-developed countries the ancient Chinese rule of 10 per cent. is a more appropriate rate. The limit is a matter of empirical observation, likely to vary according to the time and habits of the people; but it is all the same a narrow limit in an under-developed country like India, and when taxation is pushed beyond the point in an effort at checking inflation, it merely leads to a high cost of living and an inflationary rise in prices. Price controls, rationing and other direct controls are

then resorted to in the hope that in due course production and the real national income grow enough to carry the burden without controls. But that takes time and there is the tendency to escape into inflation. The excessive burden of taxation destroys the incentive to save, invest and produce, and as the economy gets bogged into unemployment and depression, influential sections of the community become willing to support a depreciation in the value of money. This brings down the proportion of taxes to the national income, but unless the fundamental causes are otherwise checked and controlled, the circle of higher taxes, higher prices, more Government spending and more inflationary pressure repeats itself.

40. 4. Taxation—A Weapon of Restricted Use.—It has been said that taxation is not the only measure available for regulating inflation or deflation. Even in advanced economies, it must be combined with other measures, for exclusive reliance on taxation would involve such large and frequent fluctuations in taxes as to add a new element of instability in the economic system. Even such large fluctuations cannot succeed in producing the desired results in under-developed economies. It must be therefore concluded that in India there are strict limits to the scope and usefulness of tax policy as an instrument for dealing with inflationary and deflationary situations.

Question 41.—In countering inflationary or deflationary conditions in the economy, what part would you assign to changes in the following: (a) direct taxes (b) indirect taxes, (i) import duties, (ii) export duties, (iii) excise duties, (iv) sales tax?

41. 1. Role of Direct Taxes in Countering Inflationary and Deflationary Tendencies.—The limitations of tax policy as an instrument for dealing with inflationary and deflationary situations have been referred to in answer to the preceding Question. These limitations are inherent in an under-developed economy. The main burnt of direct taxes falls on a very small segment of the population and in this lies the difference between India and other advanced countries. For example, as shown in Table No. 1. III, in the U. K. direct taxes on income and profits are paid by about 20 million people equal to 40 per cent. of the total population and contributing about 80 per cent. of the total national income. The same is the case in the U. S. A. where about 55 million people representing approximately 40 per cent. of the total population pay direct taxes to Government. In India, on the other hand, because of the smallness of the industrialised sector, the coverage of income and profit taxes is extremely small. In 1950-51, out of a total population of about 360 million, only about 5 lakhs* paid income-tax and super tax. In other words, direct taxes amounting to about 30 per cent. of the total revenue are borne by about one-eighth of 1 per cent. of the total population equal to about half of one per cent.** of the working force in the country estimated at 133 million in 1948-49. Again, within this narrow range, almost 50 per cent. of the direct taxes are derived from corporations and approximately 40 per cent. collected from the upper income brackets above Rs. 25,000 covering barely 5 to 6 per cent. of the total number of income-tax assesseees. This is apparent from Table No. 41. I. In contrast, wage incomes subject to income-tax in the U. K. in 1951-52 amounted to about £7,000 million or two and a half times as much as the taxable profits and gains from business, profession and vocation which amounted to about £2,800 million out of the total national income estimated at £12,700 million. When such a large proportion of the total population and the total national income is covered by direct taxes as in the U. K., adjustments are always easier to make, and when made, they are capable of proving effective

*See The First Five Year Plan, Ch. III, Para. 13.

**See The First Five Year Plan, Ch. III, Para. 11.

TABLE NO. 41. I

Kind of Income	1948-49		1949-50	
	Number of Assesseees as Percentage to Total Number	Income and Super Tax paid as Percentage to Total Tax	Number of Assesseees as Percentage to Total Number	Income and Super Tax paid as Percentage to Total Tax
Non-corporate :—				
Under Rs. 25,000	92.9	13.5	92.1	12.3
Rs. 25,000 and Above	5.5	38.7	6.2	37.4
Corporate	1.6	47.8	1.7	50.3
TOTAL	100.0	100.0	100.0	100.0

(Source : Central Board of Revenue, All-India Income-tax Revenue Statistics, 1948-49 and 1949-50.)

in practice. It is otherwise in India. For example, in 1946-47, the highest bracket of personal income bore tax at 97 per cent. of the total income as against 59 per cent. in 1939-40 and company tax stood at 48 per cent. against 22 per cent. in 1939-40* in addition to E. P. T. at 60 per cent. Notwithstanding these drastic increases in the rates of direct taxes, the tax system failed to drain off the surplus purchasing power and thus control inflationary pressures through public finance. The relative and absolute smallness of the coverage of income and profit taxes and the almost complete exemption of the enormous agricultural sector from the levy of such taxes severely restricts the effectiveness of direct taxes in countering inflationary and deflationary conditions.

41. 2. *Scope of Indirect Taxes.*—If the tax system is to be a more useful weapon for controlling inflationary and deflationary conditions, it must impinge on the rural sector covering the major part of the population so as to affect their individual incomes and expenditure. As the Planning Commission recognises—

“When the scope for direct taxation is limited, the incomes of the greater part of the population can be reached only through taxation of commodities.”**

It is from this point of view that the potentialities of indirect taxes have to be considered.

41. 3. *Influence of Import and Excise Duties.*—Import duties are regarded as useful for countering inflationary and deflationary trends. When, as in the U. K., foreign trade constitutes a fairly large proportion of the total trade and imported goods enter in a substantial measure in the daily living of the people, variations in import duties have a direct impact on the volume and direction of personal expenditure and as such are capable of exercising an influence on inflationary and deflationary conditions. In India, the position is different. Foreign trade is a small fraction of the total trade and imported articles are not widely consumed, particularly in rural areas. In the circumstances, import duties have to be combined with excise duties to produce any appreciable effects. Even so, as the Planning Commission notes,† 17 per cent. of the total tax revenue of the country comes from import duties on luxuries and 8 per cent. more from excise duties on tobacco and cloth so that a fourth of the total tax revenue is derived from import and excise duties borne by certain limited strata of society. However, on the whole, the spread of import and excise duties is much wider than that of direct taxes and they can be of assistance in influencing inflationary and deflationary trends.

41. 4. *Influence of Export Duties.*—Export duties stand on a different footing than import duties and their scope is extremely restricted. The Export Promotion Committee (1949) observes:

“It may be said, as a general rule, that to tax exports is to reduce exports. Hence it is that the great exporting countries of the world have hardly ever had a tax on exports.”‡

Even in exceptional cases, export duties can only be imposed on commodities in respect of which the country enjoys a monopoly or semi-monopoly. For example, immediately after devaluation in 1950, high export duties were levied on jute, cotton, oilseeds and other commodities in short world supply with the object of intercepting the “unearned increment” in price likely to accrue to exporters following upon the change in the rate of exchange. The extent to which export duties can be usefully employed is dependent on the degree of elasticity of foreign demand in respect of the goods exported. In any case, in strongly competitive world markets constantly searching for substitutes, such duties cannot be maintained for long or at a high level without endangering the position of the exporting country in international trade.§ The scope of export duties is thus limited to those commodities which are monopolies or semi-monopolies and to those exceptional circumstances which arise when the depreciation of a country's currency is followed by a period during which internal and external prices move into a fresh alignment on the basis of the new rate of exchange. Export duties cannot be retained for long without doing damage to the fiscal system and they cannot normally be employed for controlling inflationary or deflationary trends.

41. 5. *Role of Sales Tax.*—In comparison with customs and excise duties, sales taxes have a wider coverage in respect of the area to which they apply and the number of persons they affect. The Planning Commission reports that—

“In India, apart from these two sources (import and excise), it is clear that increasing reliance will have to be placed on sales taxes. Through sales

taxes can be reached commodities not covered by either import or excise duties.”*

These taxes, first imposed in Madras in 1939-40, have now spread to all important States and their operation has been extended to a large number of commodities in daily use. At places differential rates have been levied on necessities and luxuries and everywhere the yield has been rising at such a rapid pace as to make these taxes the principal source of revenue in State budgets. As their importance grows, sales taxes will exercise greater influence on the flow and volume of income and expenditure and their usefulness as an instrument for correcting inflationary and deflationary trends will correspondingly increase. Their main defect lies in the lack of uniformity and co-ordination without which they cannot be employed as a weapon for implementing national policies. The diversity in rates, procedure and methods of levy now obtaining detract from their usefulness. Centralisation of sales tax administration would remove these defects, and if a country-wide system is set up to function as effectively as income-tax does in the field of direct taxes, there is little doubt that, within the inherent limits of a fiscal policy, the two together can be wielded to a good purpose and with marked effect in countering inflationary and deflationary conditions.

Question 42.—To what extent is it possible to increase the inherent capacity of the tax system to counteract inflationary or deflationary conditions in the economy?

42. 1. *Limited Effectiveness of the Tax System.*—The tax system performs its regulatory functions by acting on the flow and volume of Government and private income and expenditure and its limitations in countering inflationary and deflationary conditions in India arise directly out of the limitations of an under-developed economy. A huge population of 360 million and a national income of Rs. 8,730 crores yield a per capita income of Rs. 255 per annum, implying a standard of living on the bare margin of subsistence. Taxes involve a subtraction from this marginal standard and hence the severe restriction on their scope and capacity.

42. 2. *Modification of Tax System necessary to Increase its Effectiveness.*—In the present circumstances, taxes constitute but a small proportion of the national income and their coverage is scanty and uneven, with the burden falling on a relatively small section of the population. The concentration on direct taxes on income and profits and on the urban population imposes unusual strains and leaves no room for manoeuvre. On the other hand, the bulk of the total population remains more or less outside the orbit of effective taxation. Though the per capita income is small, the large size of the population magnifies the volume of total income not readily susceptible to the influence of the tax system. It follows that, unless the taxes are broadly based and spread widely over the large mass of the people, they cannot function effectively as a stabilizer in the economy of the country.

42. 3. *Economic Development necessary for Increasing Effectiveness of Tax System.*—It is characteristic of a marginal economy like that of India that it should be in a state of precarious balance. The critical limits at all points are closely set and relatively small changes in any direction produce disproportionately large effects, sometimes in a direction opposite to that intended. A reference has been made in the answer to Question 40 above to Colin Clark's empirical observation that in under-developed countries attempts to contain inflationary pressures by closing the gap through sharp increases in tax rates merely promulgate inflation in the process till the ratio of taxes to national income reverts to about 10 per cent. This pinpoints the fundamental weakness of the position and underlines the main conclusion that a permanent and progressive increase in the inherent capacity of the tax system to counteract inflationary and deflationary conditions can be attained in a country like India only when there is a rapid growth of the national income, bringing with it a substantial addition to the per capita national income and a rise in productivity and the general standard of living.

Question 43. What are your views in regard to the relative importance of public expenditure policies in moderating the forces of inflation and deflation in Indian conditions?

43. 1. *Influence of Public Expenditure on Inflationary and Deflationary Conditions.*—Direct and indirect taxes influence private spending and investment by affecting the prices and quantum of goods available for consumption and by influencing the ability and the incentive to save and invest. The revenue received by the State from direct and indirect taxes becomes the source of public expenditure and investment. Public expenditure is also incurred from public borrowings and through deficit financing. Accordingly, public expenditure helps to determine the level of employment, production and income in the country and can be used as an instrument for influencing inflation and deflation.

* The First Five Year Plan, Ch. III, Para. XIV.

* See Table No. 3. I.

** The First Five Year Plan, Ch. III, Para. 16.

† See The First Five Year Plan, Ch. III, Para. 11.

‡ Report of the Export Promotion Committee (1949) Part II, Sec. 3, Para. 1.

§ See Report of the Export Promotion Committee (1949), Part II, Sec. 3, Para. 3.

43. 2. *Influence determined by Quantum and directive Public Expenditure.*—In deflationary conditions, when effective demand falls off, increased public spending can moderate its effects by enlarging employment and augmenting the flow of income which revive the demand for goods and services. In the converse inflationary conditions, the brake on demand can be applied by reducing the rate of public spending. The nature and extent of the influence public expenditure can exercise on inflationary and deflationary conditions, therefore, depends on the scope available for varying the quantum and direction of such expenditure and the proportion such expenditure bears to the total national expenditure.

43. 3. *Small Quantum of Public Expenditure in India.*—As pointed out before, in an under-developed country like India the proportion of the public expenditure to the aggregate national income is relatively small, being about 88009 per cent. compared to 25 to 30 per cent. in more advanced economies. The quantum of expenditure can therefore only be raised within severely restricted limits, and when the limits are exceeded, the effects tend to become more and more disproportionate and ultimately work in a direction opposite to that intended. This places an upper limit to the usefulness of public expenditure policies as an instrument for countering inflation and deflation.

43. 4. *Unbalanced Composition of Public Expenditure.*—The large bulk of current Government spending is on defence and on general administration including tax collection.* These large expenditures, which almost monopolise the revenue budget, are relatively rigid and inelastic. They resist all attempt at reduction and narrow down the margin available for expenditure in other directions. This unbalanced make-up of public expenditure directly reduces its scope and effectiveness as a weapon for disinflation.

43. 5. *Limits to Public Spending in an under-developed Economy.*—Public spending is recognised as a powerful instrument for combating deflation, but in the peculiar circumstances of an under-developed economy, it operates in a special manner. In advanced countries, the internal productive system for essential consumer goods and external trade is capable of expanding and rapidly reacts to the stimulus of Government spending. Additional public outlay, as at the time of the New Deal in the U. S. A. and in Nazi Germany, creates new income and demand for consumer goods which is matched by higher production and this carries the economy to higher levels of activity. In an under-developed economy like that of India, the internal productive system is not capable of expanding rapidly, and as the emphasis tends to be more on investment in capital goods than consumer goods, public expenditure sets up a strong tendency for a rise in the prices of basic necessities, the demand for which increases sharply as the additional purchasing power is distributed among people struggling on the margin of subsistence. As the Planning Commission recognises—

“There is, under these conditions, the risk of creating or perpetuating pseudo-employment, which might result in a rise in money incomes without a corresponding increase in the supply of goods for sustaining the newly employed. The problem, as has been shown earlier, cannot be solved satisfactorily without a substantial increase in the productive equipment of the community, which, in turn, means more investment.”†

Public spending, therefore, cannot go beyond a critical limit, and if it does, it does not moderate the effects of deflation but merely leads to cost inflation in which the public sector appropriates a progressively larger share of a relatively fixed and inelastic quantity of resources while the private sector tends to be weighed down by inertia and depression.

43. 6. *Limitations of Public Expenditure Policies.*—It is clear from the foregoing that the character of public expenditure is not sufficiently diversified from the point of view of productive and unproductive expenditure and short and long term expenditure. Further its proportion to the national income is too small and rigid to be capable of effective reduction when circumstances so require; nor, in the peculiar context of an under-developed economy, can such expenditure be effectively raised beyond clearly set critical limits. In these lie the limitations of public expenditure policies as a weapon for moderating the forces of inflation and deflation in Indian conditions.

Question 44.—*Apart from using tax policy to counter inflation or deflation in the economy as a whole, would you suggest tax changes for dealing with the effects of rising or falling prices on particular groups of tax-payers or sectors of the economy?*

44. 1. *Taxation through changes in Price Level.*—Rising and falling prices lead to redistribution of real incomes as between various classes and groups of people because money incomes do not rise and fall exactly in

proportion to the change in prices. The comparative acquiescence of public opinion in this covert form of taxation is, as Dalton puts it, a measure of public ignorance of economic principles and of the inability of certain groups to safeguard their economic interests.*

44. 2. *Tax changes as a Corrective of Price Fluctuations.*—When price fluctuations are of wider amplitude, tax changes are far from adequate for dealing with their effects on particular groups of taxpayers. For example, writing in July 1922, Keynes made the following comment on the position of gilt-edged investors after the end of the First World War:

“The monetary events which have accompanied and which have followed the war have taken from them about one-half of their real value in England, six-sevenths in France, eleven-twelfths in Italy and ninety-nine hundredths in Germany. This is apart from the increased burden of taxation.”

Such outrageous injustice of the price mechanism cannot be corrected by tax changes. Similarly, as pointed out in the answers to Questions 12 to 16 above, during the war and post-war years, the purchasing power of earnings of fixed income middle classes in India has dropped sharply between a half and a third so that price changes have imposed on them a tax far heavier than any direct or indirect tax. Though this heavy burden cannot be completely offset, it can be relieved by grant of suitable tax concessions, particularly in the matter of higher exemption limits, larger family and dependents' allowances, liberalisation of exemption limits for life insurance premia and provident fund contributions, etc.

44. 3. *Influence of Taxes on Import and Export Prices.*—Changes in the price level also have a direct impact on import and export trade and here tax changes play a part of greater significance. In highly competitive international markets, a rise in internal prices inflicts a serious disability on exports, and when such circumstances arise, duties on imports of raw materials have to be scaled down and those on exports have to be slashed if the balance of trade is not to be dislocated. If this be not done, the effect would be, as the Export Promotion Committee (1949) says:

“To injure the export trade and thus inflict much more damage on the fiscal system than the revenue brought in by the tax can repair. The damage may not be perceptible at once. The duty generally tends to affect exports slowly, but in the end, conditions deteriorate to such an extent that it has to be quickly removed.”†

It must be remembered that, notwithstanding import, export and exchange restrictions, prices are an important determinant of the flow and volume of foreign trade. Import and export duties enter into such prices, depending on the degree of elasticity in respect of the goods concerned. Accordingly, changes in import and export duties are of importance when dealing with the effects of rising or falling prices on the business sector engaged in foreign trade.

Question 45.—*How do you assess the present situation in regard to the strength of inflationary or deflationary influences, and what adjustments, if any, in taxation are indicated in the light of your views?*

45. 1. *The Background.*—The country is in the middle of the Five Year Plan of development and expansion, which rests upon a view taken by the Planning Commission of the level of progress it is desirable to generate in the Indian economic system. The Plan is the first of a series contemplating rising expenditure designed to double the *per capita* income in a quarter of a century. This implies an annual rise in savings equal to 50 per cent. of the increased output. Since the new income is being largely generated through mobilisation of idle and unemployed manpower in the rural sector, it is unlikely that voluntary savings can increase at this rate. The Planning Commission acknowledges that—

“The process of development has always inflationary possibilities.”‡

These inflationary possibilities will have to be minimized if the development is to be orderly and the incidence not unfair.

45. 2. *The Means and the Ends.*—The total planned and unplanned investment over five years has been estimated at more than Rs. 3,500 crores. This demand has to be met from public and private savings, taxation, borrowing, external free aid, foreign capital and deficit financing.

45. 3. *External Financing and Fiscal Policies.*—Up to now, external free aid and foreign capital have filled the gap to some extent but their future contribution is problematic. Public borrowing has also been disappointing and budgetary emphasis has been on revenue surpluses to cover capital deficits. In a way, the capital

* See Dalton, Principles of Public Finance, Ch. XV, Para. 5.

† Report of the Export Promotion Committee (1949), Part II, Sec. 3, Para. 3.

‡ The First Five Year Plan, Ch. II, Para. 31.

* See Tables Nos. 16. I to 16. III.

† The First Five Year Plan, Ch. II, Para. 6.

deficits have set up an automatic tendency for revenue surpluses to accumulate and inflation in the budget has been a reflection of inflation in the country. The heavy aggregate surplus of about Rs. 300 crores from 1947 to 1952 may be imputed to taxation and to high prices induced by the Korean boom. Both these factors are on the wane. Taxation appears to have reached the point of saturation, and with the emergence of buyers' markets, world prices have tended to drop and fears of a general recession have increased. A revenue surplus of Rs. 128 crores as in 1951-52 is not likely to recur. The era of budget surpluses seems to be at an end, and as they dwindle away, the over-all revenue and capital deficits take on a new significance.

45. 4. *Monetary and Industrial Policies.*—The current year's over-all anticipated deficit of Rs. 140 crores sets no urgent problem. It marks the upper limit of expenditure, and deficit financing will be less to the extent it is not incurred, or the spending is out of the accumulated foreign exchange resources. The balance remaining will help to offset the contraction in money supply suddenly forced on the system in 1951-52, partly through creation of counterpart wheat funds and withdrawal of food subsidies, and more so through the inauguration of a restrictive monetary policy which cut off the money supply by about 10 per cent. at a time when the rate of industrial production was up by about 15 per cent. and the urban cost of living higher by nearly 6 per cent. Monetary policy cannot be employed again to drain off resources on this scale from the private sector to counteract spending in the public sector from where such expenditure sets up a strong pressure for prices to rise and inflate the cost of living. The high cost of living has imparted a hard core of rigidity to the industrial cost of production at a time when buyers' markets have emerged and wholesale and selling prices have shown signs of receding. Money wages, and since 1948 real wages, have continued to rise, and since there has been no visible improvement in the capital investment per worker or in the productivity of labour per man-hour, the real costs in industry have tended to increase. So far, the impact of these factors has been cushioned by the sharp break in raw material prices that followed upon the end of the Korean boom, but profit margins have been closing up and the questions are now of declining production and growing unemployment.

45. 5. *The Place of Deficit Financing.*—In the aforesaid circumstances, it would be unwise to take too complacent a view of the large over-all Central and State Governments budget deficits on revenue and capital accounts. Table No. 45. I (Page 179) sums up the capital budgetary position of the Centre from 1947-48 onwards and also shows the capital outlay of the States in recent years. So far, fiscal and monetary policies have combined to support public expenditure by switching over funds from the private sector. The process now continues through deficit financing. To the extent the

capital expenditure is incurred abroad, the volume of deficit financing the country can afford or comfortably take is increased by its accumulated foreign exchange balances, drafts on which dissipate the capital reserves but set up no fresh inflationary pressures at home. The accumulated sterling balances representing past savings will—upto a point—provide for development expenditure without any marked inflationary strains. The same will be the result of internal deficit financing if the domestic productive system for essential consumer goods and external trade expands sufficiently to mop up the additional incomes and demand for consumer goods arising out of public spending. The cost of living index must therefore be closely watched. As the Planning Commission advises—

"The scope for deficit financing at any particular time must be judged not so much in terms of movements in wholesale prices or in money supply but rather in the light of trends in the cost of living indices. When costs of living are high, increased purchasing power injected into the system is apt to lead to increased demand for the basic commodities of consumption and push up costs of living still further."*

The improvements recorded upto now in the industrial, agricultural and particularly in the food situation in regard to production, output and stocks will help to some extent in absorbing the inflationary pressure of spending within the country. The deflationary trends, signs of which appear to be developing in the international field, will be in a sense a more powerful factor. A fall in world prices will tend to alter the balance between the saving and non-saving groups and to ease the strains of inflation incidental to developmental expenditure. But at the same time it will stir up other thorny questions as of maintaining employment, effective demand and balance of payments equilibrium. In any case, the complexion of the problem will radically change and much re-thinking will be necessary if the recessionary trends take a more forceful hold of the world economy. For the present, there seem to be definite limits beyond which the volume of deficit financing cannot be pushed without taking unduly large risks. The inflationary potential can be held in check only if the surplus income over and above that necessary for satisfying essential wants is fed back into the monetary and capital system. If there is no saving at the level at which there is investment, prices will rise and compel reduction of consumption through inflation.

45. 6. *Present Position apparently Paradoxical.*—The present economic situation is apparently paradoxical. There does not seem to be a general inflation but a curious mixture of suppressed deflationary cum inflationary conditions. The private sector suffers from a

* The First Five Year Plan, Ch. III, Para. 39.

TABLE NO 45. I.

(In Crores of Rs.)

Year	Total Capital Outlay	Increase (+) or Decrease (—) in Permanent Debt	Increase (+) or Decrease (—) in Floating Debt	Advance to States less Repayments (Total Advances)	Other Items	Deficit on Capital Account	Capital Outlay Developmental Part A States and (Part B States)
1947-48	56.89	—18.62	+18.91	18.06 (22.45)	—58.75	133.41	
1948-49	408.99	—47.54	+286.85	26.00 (31.37)	28.05	167.48	
1949-50	122.91	—28.32	+110.57	39.74 (54.75)	0.55	80.05	52.60
1950-51	71.03	—7.76	+50.79	53.38 (61.46)	19.28	62.04	61.49 (22.76)
1951-52	118.18	+23.26	+16.42	63.49 (75.71)	17.50	124.39	79.69 (20.60)
1952-53	75.86	+20.60	+41.01	100.57 (117.12)	27.33	78.49	107.96 (22.44)
1953-54 (Budget)	76.64	—18.83	+165.52	113.63 (131.20)	13.01	30.57	126.78 (27.96)

fall in effective demand and business activity as purchasing power has been sucked off into the public sector through monetary and fiscal devices. The attempts at deflating the price level through the monetary and budgetary mechanism side by side with a development programme of reflation and the seeming prosperity of Central and State revenues secured through burdensome taxation constitute a reminder of the main fact that the current development is being financed by a reduction in the standard of living of those belonging to the private sector. Their ability to save and to invest and the incentives to capital formation have been crippled by the high taxation and the high cost of living. On the other hand, public spending has generated incomes mostly in the rural sector from where they have exerted a pressure on consumers' goods, particularly basic necessities, the prices of which have refused to drop to any appreciable extent. The cost of living and therefore the cost of production has remained stubbornly high, while declining prices and accumulating stocks have arrested capital investment and created pockets of unemployment growing larger day by day. These contradictory trends can be rationalised if the over-all deficit could be controlled. Two remedies are at hand. First, public expenditure, current and developmental, must be strictly controlled so as to eliminate all avoidable waste. And secondly, in order to support or neutralise the additional purchasing power at the point at which it is thrown into the system, conditions must be created for promoting production both in the industrial and agricultural sectors and the tax system should be suitably revised.

45. 7. Control of Public Expenditure.—When the flow of funds to the industrial sector is controlled and diverted to the public sector, it is necessary to ensure that the funds so diverted are fully and economically employed. A strong check on public spending is therefore necessary, particularly on the State Governments which have tended to be extravagant. The Planning Commission points out that—

“The revenues of State Governments have been rising over the last two years, but expenditures outside the State Plans have been more than absorbing these increases. The increase in expenditures is not only under administrative but also under other heads like agriculture, education, health, etc., where any major expansions should be normally on items included in State Plans.”*

This tendency of State Governments to spend money on items not on the approved priority list can be arrested and their ideosyncracies and fancies in throwing away lucrative sources of revenue can be curbed if the financial responsibility is passed on by the Centre asking the States to look after themselves. At present, the monolithic structure of the Central Government supports the capital budgets of various States, which receive, as Table No. 45. I shows, loans and advances from the Centre of the order of Rs. 80 crores. Devolution of financial responsibility would compel the States to practice economy by adhering to the approved plans and inculcate in them due regard for revenues now recklessly thrown away. At the same time, it would relieve the Centre of a big burden which at present, directly or indirectly, presses upon those who contribute to the Central exchequer. Example is the best form of precept. The Centre itself must practice the strictest economy in current and capital spending and it should be compelled to do so by force of an educated public opinion and a vigilant Parliament.

45. 8. Importance of the Industrial Sector and an Appropriate Tax System.—The concentration of public spending on development schemes does not drive the economy in the same way as, for example, private spending on industry does. The consequences cannot be escaped. As the Planning Commission says—

“This is likely to create inflationary pressures which might be felt strongly at particular points in the system, impinging more heavily on the real income of some sections of the population than on others The strain of development on the economy might be felt in a variety of ways, scarcities, high prices, disparate movements of incomes of different classes, bottlenecks in production, strain on transport, etc.”†

The fact of this strain will remain but the strain can be moderated through appropriate measures of policy in the field of industrial production and taxation. The flow of funds from the private to the public sector ties up that part which lies unspent with the public authorities, and the rest, which is the major part, passes into the hands of people who are not accustomed or not in a position to take increments of income in the form of increments of saving. The capital projects on which they are engaged, or the kinds of goods they produce, do not come on the market at all, or are not easily marketable, so that the new income streams are not absorbed. The resulting inflationary pressures can only be offset by production at the point where it takes place

quickest, and that is a requirement which the Industrial sector alone can fulfil.® The expansion of industry would damp down the inflation trends and at same time accelerate the tempo of tertiary activity and generate funds that can be utilized later for the public sector. The private sector is not a mere appendage to the State-planned enterprises but has a place in its own right in the context of a mixed economy. As the Planning Commission realises—

“There is no doubt that over a period the desired rate of economic progress will necessitate a rapid diversification of the occupational structure through development of industry, together with trade and transport.”**

It is a mistake of policy and emphasis to think otherwise. The private sector has, however, received perfunctory attention and its investment needs appear to have been under-rated. There can be no planning without tears, but in the interests of well-balanced development, it is necessary to create conditions in which industrial expansion becomes remunerative and profitable and in which it can secure the requisite funds from vitalised investment markets mobilising the resources of the people who have been left by the State with something to save and to invest. Herein the tax system has its part to play. If it is to succeed, the tax structure must be revised on the lines of the suggestions made in reply to this Part of the Questionnaire. In particular, taxes on incomes and profits must be scaled down to reasonable levels, and if the inflationary thrust of development spending is to be better controlled, taxes must also be properly diversified and broadly based on all economic groups including those benefiting by the new income streams. In that manner alone can revenue be raised equitably and adequately and savings, small and big, sufficiently encouraged to engage in capital formation. This is the central theme of the Five Year Plan. It has been said that taxation is the measure of the wisdom of a State; that it registers with unfailing accuracy whether a State is aware of its ‘dharma’ and secures the devotion and loyalty of its people by rendering services, or whether, by imposing unacceptable burdens, it loses their loyalty and devotion. Said Manu many centuries ago:

“The king shall fix duties in his realms in such a manner that both he himself and the man who does the work receive their due reward. As the leech, calf and the bee draw their food, little by little, so must the king draw from his realm moderate annual taxes. As the sun draws water in his rays, so let him draw his taxes from his kingdom.”

PART II—DIRECT TAXES.

Question No. 47.—Does the definition of “income” (section 2(6C)) require any modification?

47. 1. Capital Appreciation Should Not be Treated as Income.—So far as investment in stocks and shares is concerned, it is necessary to make clear that the term “income” does not include the surplus realised through sale of investment when its value has appreciated. There is a tendency to treat such appreciation as of a revenue character and tax it in the hands of investors even when it does not result from the regular exercise of a business activity as such. A provision should therefore be made that a surplus resulting from the purchase and sale of shares and securities should not be deemed to be income unless the assessee is carrying on regular business in shares and securities and the shares and securities in question are a part of his stock in trade (as distinct from his personal investment).

47. 2. Bad and Doubtful Debts Should be Allowed Before Arriving at the Taxable Income.—Bad and doubtful debts are frequently disallowed on technical grounds and this is a source of considerable hardship, particularly to stockbrokers who are engaged in a trade full of such risks. A stockbroker is not a banker or moneylender whose function is to advance credit to his client. His business is that of buying and selling stocks and shares. Therefore, when the party with whom he deals fails to meet his commitments, the debt which arises is not to be deemed a credit granted by the broker to his party. It is a loss at that point of time. In some doubtful cases, a major part of the loss may be known to be irrecoverable, there being a possibility of recovering a small part at a later date running over into the next assessment year. In other cases, the loss may be known to be wholly irrecoverable. As it is an acknowledged principle that the tax should be levied only on the true profits, and as the true profits cannot be arrived at unless bad and doubtful debts are deducted, it is necessary that the bad and doubtful debts should be allowed in the assessment year in which they actually occur so that the assessee may not be over-charged. The assessee is penalised by the Department in two ways. First, a doubtful debt is not

* The First Five Year Plan, Ch. III, Para. 34.

† The First Five Year Plan, Ch. I, Para. 21.

® See the First Five Year Plan, Appendix to Part I, Para. 8.

** Ibid., Ch. XXIX, Para. 1.

allowed as such on the ground that there is a likelihood of receiving some amount in the future against that debt. And secondly, in numerous *bona fide* cases, debts that are real bad debts are not allowed to be deducted for income-tax purposes unless legal proceedings are filed. The assessee is invited to throw away good money after bad, and even so, as legal proceedings take a long time, the bad debt is not allowed in the year in which it is actually sustained but in the following year or years in which the legal claim is formally established, in spite of the fact that the trading of that year has nothing to do with the loss. It is obvious that unless broker assesses are allowed the bad and doubtful debts in the year in which they are incurred, the brokers are bound to be placed in serious difficulties. Their profession is fraught with unusual risks of this character and the risks multiply the larger the business that is done and the larger the income that is earned. Not unoften, and particularly in times of boom followed by crisis, profits are not only substantially reduced but are altogether wiped off and even capital is affected by the bad debts sustained. When the bad and doubtful debts are not allowed and the additional burden of paying taxes on such losses is imposed, the broker assesses find themselves punished for their misfortune. The matters are frequently set right by the Tribunal but before that much harassment is caused as generally the time for paying the tax demanded is not enlarged till the appeal is decided. This should not be. The Income-tax Enquiry Committee which reported in 1936 gave its findings as follows:

"General dissatisfaction was expressed in every Province visited regarding the treatment of bad debts We are bound to state that, although bad debts were fairly treated in many cases examined by us, we have found in other cases justification for the statements made, and that the treatment of bad debt claims is one of the principal causes for the existing dissatisfaction with the Income-tax Department. In some cases, it appeared to us that the efforts of the Income-tax Officer were directed towards the discovery of technical objections to allowance rather than to the determination as a fact whether or not the debt claimed was irrecoverable.*"

The present practices of the Department continue to be as unjust and unfair as before. Now that business losses are allowed to be carried forward, it is clearly necessary to provide that bad debts and *bona fide* estimates of doubtful debts as written off in the books of assesses should be always allowed except when there is *prima facie* evidence of a deliberate attempt to write off a bad or doubtful debt in a particular year in which it has not occurred with the sole object of reducing any unusually large income that may have been earned in that year.

Question No. 48.—Are there any receipts or gains which are not taxed at present but which, in your opinion, should be taxed and vice versa? In particular, what is your view regarding the taxing of capital gains?

48. 1. Brief History of Capital Gains Tax.—Capital gains tax was introduced in India in 1946 and abolished in 1948. The reasons for levying the tax were explained by the Finance Minister in his 1946-47 Budget speech as under:

"Honourable members must be aware of the extent to which large capital gains have been made in recent years and are still being made owing to prevailing conditions. These profits are, as the law stands, outside the scope of the Income-tax Act. I feel very strongly that the lacuna should be filled. There is stronger justification for taxing these profits than there is for taxing ordinary income since they represent what is properly described as unearned increment. The U.S.A. taxes such profits."

The tax was wholly misconceived in its origin and in its reliance on American experience. On account of the inflationary rise in prices and the fall in the value of money, what were described as "profits" and "unearned increment" did not represent any real (as distinct from money) increment in or addition to the value of capital. The tax was therefore not on capital "profits" or "unearned increment" but on capital itself. As was pointed out in the Minority Report of the Select Committee to whom the Bill was referred:

"It will be observed that the element of inflation would indirectly be set off, if the above tests were applied to a valuation. The determination of the value of property in America follows an elaborate procedure intended to ensure a fair deal for the assessee. Simplicity, on the other hand, has been claimed as a merit of the present taxation proposals, but we are afraid that for the sake of such simplicity, many of the safeguards and limitations recognised in U.S.A. have been overlooked. We have to point out that the very vast differences in econo-

mic conditions and wealth accretion between U.S.A. and India have been ignored in framing this measure. The rapidity with which capital assets change hands in U.S.A. is very much greater than even that which exists in European countries and the United Kingdom, and the caution and circumspection which should have been employed in drawing a parallel from U.S.A. from this point of view, do not appear to have been bestowed by Government on this measure."

The fears expressed in the Minority Report that the capital gains tax would have a—

"deleterious effect on existing enterprises and on the investment of capital in new enterprises."

proved to be well founded. Referring to the tax in his 1948-49 Budget speech, the Finance Minister declared—

"At the time this tax was introduced it was expected to yield a large revenue, but it synchronised with a period of falling values and the yield from this tax has, in consequence, been small. Its psychological effect on investment has, however, been markedly adverse and it has had the effect of hampering the free movement of stocks and shares, without which it is hardly possible to maintain a high level of industrial development. In present circumstances, I consider the retention of this tax ill-advised. The loss of revenue is estimated at Rs. 1 crore."

It was in these terms that the capital gains tax was repealed in 1948 within a brief period of two years from its inception.

48. 2. Adverse Effects of Capital Gains Tax on Savings and Investment.—A capital gains tax reacts adversely on savings and investment. It heightens the scarcity of savings by discouraging the free and rapid circulation of securities. Transfer of savings from one direction to another, from an old security to a new one, implies the precedent fact of realisation. Since such realisation attracts the capital gains tax and brings about an immediate loss of capital, the investor prefers the bird in hand to two in the bush. Savings lose their mobility. People cling to old securities and the new capital market is neglected. The dog-in-the-manger policy which the capital gains tax embodies helps no one. Government does not benefit in revenue but on the contrary loses because of the negative burden involved in the maintenance of an administrative staff; the investor also does not gain but on the other hand foregoes a potential profit; and equally new enterprise languishes and those who require funds for productive purposes either do not secure them or secure them at too high a cost. The diminution in the velocity of circulation which the capital gains tax brings about tantamounts to diminution in the amount of savings itself. It thus burdens the investor and handicaps the investment habit.

48. 3. Other Defects of Capital Gains Tax.—The capital gains tax suffers from several other defects and produces all kinds of inequities; namely:—

- (a) Capital gains, by definition, do not represent income arising from the pursuit of any regular business activity carried on with a view to earning a profit. They are in the nature of windfall gains and like other gains of that character they should not be subjected to tax.
- (b) Capital gains occur chiefly in periods of inflation. As such they do not represent any real gain but merely a paper profit on account of the fall in the value of money. To tax them is, in effect, to tax capital and not profits or gains.
- (c) Capital gains do not occur regularly. They are booked at a time perhaps after years of waiting and to lump them together for tax is to impress a greater burden in a single year than due.
- (d) Capital gains and losses fluctuate widely and tend to cancel each other. If capital gains are taxed, capital losses have to be allowed, with the result that the tax turns out to be an extraordinarily ineffective revenue producer.
- (e) Capital gains are generally not consumed but again re-invested in one form or another. A tax on such gains acts as a disincentive, particularly in the case of small investors, whereas exemption encourages fresh investment.

48. 4. Capital Gains Tax Generally Not Favoured.—The capital gains tax has not found favour in most parts of the world. In fact, with the exception of the U.S.A., it is not widely prevalent abroad. Even in the U.S.A.—a wealthy and highly industrialised country—no feature of the tax system has been subject to more complaint*

* Income-tax Enquiry Report, 1936, Ch. VI, Sec. 4, Para. (c).

* See W. R. Green, "Theory and Practice of Modern Taxation", p. 120.

than the tax on capital gains. Any extension of the American practice is generally regarded as far from desirable.** The objections have greater force in the case of a country with an under-developed economy like that of India. It is for this reason that the recent U. N. Public Finance Survey of India concludes that—

“The capital gains tax seems to have been neither popular nor successful.”@

It follows that a capital gains tax is not a suitable instrument of taxation and it should not find a place in the tax system of the country.

Question No. 50.—What change, if any, is called for in the definition of “dividend” (section 2(6A)); e.g., in relation to “bonus shares”?

50. 1. Nature of Bonus Shares.—The present definition of the term “dividend” takes out bonus shares from within its purview when such shares do not entail the distribution of the assets of the Company. This provision is in accordance with the view expressed by the House of Lords in the U. K. in C. I. R.V. Blott (8 T. C.

** See Spaulding, “The Income-tax in Great Britain and United States”, Ch. XI.

@ U. N. Public Finance Survey—India, 1951, Ch. IV, p. 41.

101). The profits of a company are subject to income-tax at the maximum rate as well as to company super-tax in the year in which they are earned, irrespective of whether such profits are distributed as dividend or whether they remain undistributed and are carried to reserves. The taxed earnings of a company which remain undistributed and accumulate as reserves actually enter into the price of its shares as quoted on the Stock Exchanges where they change hands from seller to buyer on this footing. When the reserves are capitalised by means of bonus shares, there is a change in form but not in substance. The assets remain with the Company and on the issue of bonus shares the market value of the original shares drops correspondingly. In general, the *cum*-bonus market value of the original share is equal to the *ex*-bonus market value of the original share plus the value of the bonus share. This is apparent from Table No. 50, I (Page 190) which summarises the changes in market value following upon bonus issues made during the last decade in respect of shares quoted on the Stock Exchange in Bombay. It is clear from the Table that the shareholder who receives bonus shares does not get anything extra and that when he sells the bonus shares he does not in effect make profit or gain equal to the full value of the bonus share, as is sometimes mistakenly imagined.

TABLE No. 50, I.

Ordinary Shares of	Last <i>Cum</i> -Bonus Rate	First <i>Ex</i> -Bonus Rate	Ratio Between Old Shares and Bonus Shares	
			Old	Bonus
	Rs.	Rs.		
1944—				
Poddar Mills	480	441	5	1(P)
1946—				
Madhusudan Mills	568	550	1	1(P*)
Walchandnagar Industries	835	429	1	1
1947—				
Madhusudan Mills	435	300	2	1
Mysore Mills	285	240	3	1
Wimco	654	275	1	1
Poona Electric	205	170	4	1
Walchandnagar Industries	310	165	1	1
Bombay Dyeing Mills	2,070	1,030	1	1
Century Mills	975	500	1	1
Simplex Mills	333	225	2	1
Premier Construction	271	264	1	1 (P**)
1948—				
Ahmedabad Advance Mills	565	270	1	1
Coorla Mills	300	147	1	1
Laxmi Cotton Mills	1,690	800	1	1
Minerva Mills	193	189	5	1
Sassoon Silk Mills	78	30	2	3
Shrinivas Mills	460	230	1	1
Standard Mills	580	250	1	1
Vishnu Mills	630	320	1	1
Bombay Suburban Elec.	151	138	8	1
Poona Electric	150	145	7	1
Alembic Chemicals	258	205	4	1
Indore Malwa Mills	510	205	2	3
Morarjee Goculdas Mills	601	490	1	1 (P)
New Great Mills	363	175	1	1
Kohinoor Mills	628	318	1	1

P—Preference Share of Rs. 100.

P*—Preference Share of Rs. 12-8.

P**—Preference Share of Rs. 10.

TABLE No. 50. I—contd.

Ordinary Shares of	Last Cum-Bonus Rate	First Ex-Bonus Rate	Ratio Between Old Shares and Bonus Shares	
			Old	Bonus
1948—contd.	Rs.	Rs.		
Swadeshi Mills	609	299	1	1
Century Mills	531	270	1	1
Belapur Sugar	347	279	4	1
Premier Construction	220	199	1	3 (P**)
Indian Manufacturing Mills	4,150	3,025	1	1 (P@)
Western India Spg. Mills	4,070	2,925	1	1 (P@)
1949—				
Wimco	283	196	7	3
Swadeshi Mills	292	240	4	1 (P)
1950—				
Bombay Dyeing Mills	1,060	540	1	1
Morjee Goculdas Mills	435	144	1	2
1951—				
Shrinivas Cotton Mills	195	178	4	1
1952—				
Elphinstone Mills	51	42	5	1
Simplex Mills	274	185	2	1
Pulson	111	109	5	1
Finlay Mills	321	250	4	1
Swan Mills	463	305	2	1
Wimco	238	195	4	1
Simplex Mills	168	135	3	1
Associated Cements	177	147	5	1

P—Preference Share of Rs. 100.

P*—Preference Share of Rs. 12/8.

P**—Preference Share of Rs. 10.

P@—Preference Share of Rs. 1,000.

50.2. *Bonus Shares and Dividend Distinguished.*—Bonus shares and dividends cannot be equated. The position when bonus shares are issued is the opposite of that which arises when dividends are distributed. The shareholder receiving the dividend in cash gets something extra. His interest in the Company is not altered but remains the same as before. He is also entitled to refund or credit in respect of the income-tax paid by the Company on the dividend. What happens when a shareholder sells his bonus shares is that his interest in the Company is reduced. He realises in cash a part of his old capital, the other part remaining in the original share which is quoted in the market at an ex-bonus price lower by approximately that amount. Further, the assessee receiving the bonus share is not entitled to refund or credit of income-tax at the maximum rate paid by the Company in the year in which the profits were earned before being carried to the reserves that are capitalised in the form of bonus shares. In such circumstances, to attempt to include bonus shares in dividend and to tax the bonus issue or its equivalent in sale proceeds would be to tax capital formed out of profits and gains which have been already subjected to tax in the year in which they are earned. The position has been correctly appreciated by the Bombay High Court in the Commissioner of Income-tax (Central), Bombay vs. Maneklal Chunilal & Sons, Ltd. (Income-tax Reference No. 16 of 1948). It was a case in which the bonus shares had been issued in the form of Preference shares which had been subsequently disposed of by the assessee, the sale proceeds of which were sought to be taxed by the Department as profits and gains. In his judgment delivered on the 23rd of March, 1949, the Chief Justice held as follows:

"Although the Assessee did not pay anything for these preference shares, these preference shares were the result of the Assessee's buying ordinary shares at a certain price in respect of which these preference shares were issued, and, therefore, we

have got to consider first what did it actually cost the Assessee to get these preference shares, and the proper method, in my opinion, would be to treat the ordinary shares, and the preference shares as having been bought at the price for which the ordinary shares were purchased by the Assessee and then to allocate that price as between the ordinary shares and the preference shares in proportion to the value of ordinary and preference shares at the date when the preference shares were issued. Having allocated the price, the profit has to be assessed between the price allocated and the price realised by the sale of these shares."

The judgment brings out the fact that bonus shares are not income or profits which can be taxed as dividend is taxed and this view receives full support in the actual facts of day-to-day market experience.

50.3. *Bonus Issues Cannot be Taxed.*—It has been shown above that bonus issues do not represent income or profit, and that, if they are taxed, that would amount to taxing capital formed out of profits which have already been subjected to tax in the year in which they accrued. Apart from this basic objection, other serious anomalies would also arise should there be any departure from the present position. Bonus shares are issued out of accumulated undistributed profits earned and taxed from year to year over a period during which the original shares may continue to change hands a number of times. In other words, the shareholder receiving the bonus shares is not necessarily the shareholder who was on the books of the Company when the profits were actually earned and taxed. Even if he is, it is obviously inequitable that profits accumulated over a number of years should be impressed to super-tax in his hands in the one particular year in which the bonus shares are received. What that must imply in terms of the rating of the tax and its incidence requires no elaborate comment. On the other side, where the shareholder is not assessed to super-tax, there is also an inequity unless

provision is made for granting refund or credit of income-tax collected at the maximum rate on the undistributed profits as they are earned and accumulated from year to year till finally capitalised and allotted to shareholders in the form of bonus shares. It is sufficiently clear that any attempt at creating equity out of such inequities is bound to result in further complications, introducing an unpredictable element of uncertainty and risk in the market valuation of stocks and shares. Ploughing back of profits, which plays such an important part in the self-financing of industry, would also be greatly hampered if any change is made in the existing practice, much to the detriment of the economic development of the country at large. The conclusion therefore is that whatever the point of view it would be a mistake of fact and substance and a mistake in equity to confuse bonus shares with dividend and include them in the purview of the term "dividend" as defined in Section 2(6A) of the Indian Income-tax Act.

50. 4. *Dividends Should be Taxed According to the Source.*—When taxing dividends, it is necessary to provide that they should be examined for their source and such part as is derived from non-taxable sources should be exempted from tax. In other words, income that is free of tax or is not taxable in the hands of the Company, for example, agricultural income, should not be taxed in the hands of shareholders when received by them in the form of dividend.

50. 5. *Definition of the Term 'Shareholder' for Dividend Purposes.*—According to the general principle laid down in *Calico Printers' Association vs. Commissioner of Income-tax, Madras* (1948-2 M. L. J. 536), dividend or interest on transferred shares or securities is deemed to be part of the income of the transferee or real owner. However, some confusion has been caused by two decisions of the Bombay High Court (*Cambatta's Case* 1946—I.T.R. 748—and in re. *Shri Shakti Mills, Ltd.*—1948 I.T.R. 187). As the Income-tax Investigation Commission observes—

"The stress there laid on the word 'dividend' may give rise to administrative difficulties in giving effect to Sections 16(2), 18(5), 20 and 49-B which specifically refer to 'dividend'. For instance, it will be an anomalous situation if the unregistered transferee of shares can be assessed as beneficial owner, but he cannot claim refund or credit under Section 49-B because he did not draw the dividend in cash. A question may also arise whether the shares though not registered in the beneficial owner's name may be sold for realisation of income-tax due from the beneficial owner. It seems desirable to make specific provision in respect of these matters. To this end, a clause may be inserted in the definition section to the following effect—

'Shareholder' is a person beneficially entitled for the time being to the share or to the dividend payable in respect thereof."*

To avoid all ambiguity, it seems desirable that a provision should be made on the lines recommended by the Income-tax Investigation Commission.

Question No. 56.—Do you think the present provisions regarding exemption of charitable and religious trusts need any modification? If so, in what respects?

56. 1. *Broad Definition of the Term "Charitable Trusts" Desirable.*—Charitable trusts ensuring for the benefit of the public or a section of the public are exempt from taxation. There is a tendency to interpret the term "section of the public" in an extremely restricted sense. For example, exemption is not available to a trust constituted for the purpose of giving charitable assistance to the members of an association when they are in distress or to the families of deceased members. The scope should be suitably enlarged as it is necessary to encourage charities fulfilling functions which it is really the duty of the State to discharge. In any case, when exemption is not allowed to charitable trusts on purely technical grounds, they should not be taxed at the maximum rate but at the appropriate rate applicable to the actual income of the fund.

Question No. 58.—Are you in favour of continuing the concessions given to new industrial undertakings under section 15C of the Income-tax Act? Have initial and extra depreciation allowances made the concessions particularly infructuous? If so, what are the directions in which the provisions of this section should be modified?

58. 1. *Tax Concessions to Industrial Undertakings.*—The country is largely underdeveloped in relation to its resources and its needs. If capital is to be attracted to new industrial undertakings and if expansion and modernisation are to be encouraged, the necessary inducement must be offered in the form of suitable tax concessions. The concessions now given under Section 15C are largely of a nominal character. The accelerated initial and extra depreciation allowances only ante-date

the amount of allowances which in any case can be claimed over a number of years. Further, ordinarily new enterprises do not earn profits large enough to cover the special depreciation and give a 6 per cent. return on capital. The benefits given by Section 15C should therefore be enlarged and liberalised on the following lines:

- (a) A lower rate of tax should be charged or in special cases total exemption from tax should be granted to new industries for a suitable period.
- (b) The unconsumed portion of the special depreciation allowances plus four per cent. return on capital should be allowed to be carried forward till absorbed in subsequent years.
- (c) Exemption from tax for a suitable period should commence from the date when taxable income results after providing for depreciation and losses, whether current or brought forward from previous years.
- (d) Exemption from tax should be given in respect of profits upto 6 per cent. of capital plus depreciation allowances provided they are utilised for rehabilitation and expansion of existing industrial undertakings.
- (e) Dividends out of profits exempt from tax as in (d) above should also be exempt from tax in the hands of the recipient shareholders.

Question No. 60.—Should any liberalisation be made in the present limits of exemption from tax of life insurance premia and contributions to provident funds?

60. 1. *Provident Fund and Life Insurance Premia Limits should be Liberalised.*—In India, the State does not provide old age, sickness, unemployment and such other benefits. Individuals have therefore to look after themselves and provide for their dependents. The exemption from tax of life insurance premia and provident fund contributions is intended to encourage thrift and saving for the purpose of providing for such contingencies. A large part of such saving is invested in gilt-edged securities and is thus available for the development of the country. However, in view of the fall in the value of money and the change that has taken place in the general standard of living, the overall limits of exemption from tax which were fixed years ago stand in need of revision. At present, the total of employer's and employee's contributions and interest earned in the provident fund plus life insurance premium paid by the assessee is exempt to the extent of one-sixth of the total income or Rs. 6,000, whichever of the two is less. These overall limits should be raised to one-fourth of the total income and Rs. 12,000 respectively. Further, the same privileges should be accorded to all provident funds as are now available to the provident funds governed by the Provident Fund Act, 1925. Liberalisation on these lines would provide welcome relief and at the same time and the present discrimination against other than Government employees for which there is no justification on ethical or any other ground.

Question No. 61.—(i) Do you favour the grant of larger depreciation allowances to assist industry to finance the considerably increased costs of replacement of assets? If so, how and in what form should they be given—(a) by larger depreciation allowances on new assets; (b) by revalorisation of existing assets; (c) by treating the excess of replacement cost over original cost as revenue expenditure; (d) by any other method?

(ii) What is the justification for assistance from public resources to certain classes of tax-payers only by way of covering partially the excess of replacement cost over original cost of old assets?

(iii) In case adequate justification exists for assistance by Government in the form of tax concessions to meet the situation, what safeguards should be prescribed to see that the funds so made available are utilised for the purposes for which they are intended?

61. 1. *Basic Principle Underlying Depreciation Allowances.*—Income-tax is chargeable not on capital but on the profits and gains of business. In order to arrive at such profits and gains assessable to tax, it is obvious that depreciation allowances should be granted to an amount which will enable the assessee trade or industry to replace any capital that is used up in the year's trading or active operation. Unless this basic principle is followed, there is capital erosion whenever there is inflation leading to a heavy depreciation in the value of money. The depreciation allowances so made represent in effect expenditure that must be deducted for arriving at the true income of the assessee. This is not an act of special favour, nor does it amount to assistance from public funds. Such reserves merely enable industry to keep its capital in tact and specific provision in this behalf credited to a rehabilitation fund earmarked for replacement of plant and equipment should be treated as an admissible expense.

* Report of the Income-tax Investigation Commission, 1949, Part I, Para. 185.

Question No. 64.—In what form would you provide for personal and family allowances—

- (i) exempting the first slice of income from tax; or
(ii) providing specific allowances for family and dependents?

In the case of (i), do you consider that the first slice—Rs. 1—1,500—should be revised? In the case of (ii), what treatment would you give to the Hindu undivided family?

64. 1. Personal and Family Allowances—A Comparative Picture.—An assessee is an earning member of the community and as such he has family and social responsibilities to discharge. In other countries, allowances are available in respect of dependents, infirmity, old age, sickness, unemployment, etc. In India, where large families are the rule and custom enjoins support of non-earning relatives, the responsibilities are greater but personal and family allowances are either meagre or do not exist. Because of this, a married assessee with two children and earning an income below Rs. 5,000 is liable to pay a higher tax in India than, for example, in most other countries in the Commonwealth or the U.S.A. Table No. 64. I sets out the income limits above which a married man with two children becomes liable to pay tax in various countries. If the allowances available for dependents other than

wife and two children and the allowances for medical expenses, old age and infirmity are taken into account, the relative position of the Indian assessee is seen to be much worse. This is evident from Tables Nos. 64. II and 64. III. These allowances enable assessee of maintain a minimum standard of living.

TABLE No. 64. I.

Country	Limit above which Income is Liable to Tax		Country
	Rs.	Rs.	
Japan . . .	1,000	10,000	South Africa
France . . .	2,400	11,400	U. S. A.
Australia . . .	2,800	12,825	Canada
India . . .	4,200	15,000	Egypt
U. K. . . .	6,520	18,100	Brazil
Sweden . . .	6,820		

(Source: Economic Trends, April 1952, p. 12).

TABLE No. 64. II.

(In Rs.)

Country	Minimum Income Not Taxed	Personal Allowance	Dependents' Allowances		
			Wife	Children	Others
India	4,200	1,500	Nil	Nil	Nil
U. K.	1,800	1,600	1,200	Rs. 1,133 for each child under 16	Rs. 666 for aged or infirm relative
U. S. A.	2,862	2,862	2,862	Rs. 2,862 for each child	Rs. 2,862 for each
Canada	4,580	4,580	4,580	Rs. 1,832 for each child under 21	Rs. 1,832 for each dependent under 21
Australia	1,120	Nil	1,120	Rs. 840 for each child under 16 and Rs. 560 for others	Parent Rs. 1,120. Others Rs. 840
S. Africa	3,266	Rebate from Tax	120	Rs. 133 for each child under 18	Rs. 33 for each dependent
Japan	400	400	200	Rs. 200 each	Rs. 200 each

(Source: Economic Trends, April 1952, Table B, pp. 10-11.)

TABLE No. 64. III.

(In Rs.)

Country	Old Age and Infirmity Allowance	Medical Relief
India	Nil	Nil
U. K. (1952-53)	If over 65, 1/5 of total income (not exceeding Rs. 6,666) tax-free	Nil
U. S. A. (1952-53)	For self and wife old age Allowance Rs. 2,862, Blind Allowance Rs. 2,862	Expenses in excess of 5% of Total Income Deductible—Maximum for single Rs. 5,942, for married Rs. 11,925, with one dependent Rs. 17,887 and two or more Rs. 23,850
Canada (1950-51)	Old Age—Rs. 2,290 Blind or Illness—Rs. 2,290	Expenses in excess of 4% of Income Deductible—Maximum for single Rs. 3,435 for married Rs. 4,580 and Rs. 1,145 for each upto 4 dependents.
S. Africa (1950-51)	Nil	Nil
Japan (1951-52)	Old Age—Rs. 200 Infirmity—Rs. 200	Expenses in excess of 10% of Income. Maximum Rs. 1,333

(Source: Economic Trends, April 1952, Table B, pp. 10-11.)

64. 2. *Desirability of Providing for Personal and Family Allowances.*—In India, the attainment of a welfare state is still a distant objective. It would be therefore obviously in accordance with considerations of equity and ability if the family and social responsibilities of an assessee were recognised when determining his tax liability. On this view, the first slice of income amounting to Rs. 1,500 should continue to be exempt from tax as at present with the addition of a scheme of allowances, say, Rs. 1,000 in respect of each dependent son under twentyone years of age and each dependent daughter (who should be unmarried or a widow if over twentyone years of age) and an allowance of Rs. 500 for each dependent relative maintained by the assessee throughout the year. The exemption limit should continue as hitherto, that is, the first slab of Rs. 4,200 of the income of an individual assessee should remain as the non-taxable maximum as at present. A provision on these lines is long over-due and would give welcome relief particularly to hard-pressed assesseees of moderate means.

Question No. 65.—Should the present law regarding admissible expenses (section 10(2)) be altered? If so, please indicate, with reasons, the items of expenses (i) which are not now admissible but, in your view, should be admissible and (ii) which are now admissible but, in your view, should not be admissible.

65. 1. *Admissible Expenses—Advisability of Broadening the Definition.*—There is a tendency for the Department to disallow legitimate business expenses, particularly under the heads bad debts, entertainment and transport where broker assesseees are concerned. All attempts are made at present to shut out items of business expenditure on the purely technical ground that they have not been incurred wholly for purposes of business. It is therefore advisable to widen the definition of admissible expenses to cover all expenses incurred by an assessee in the course of his business or incidental thereto. The subject of bad debts has been dealt with in some detail in the answer to Question No. 47 above. As regards entertainment, travelling and such other expenditure, the Income-tax Investigation Commission recommends as under:

"As we are anxious to see that the relations between the Department and the assesseees improved, we would recommend that the Income-tax Officers may be instructed not to be unduly strict about the amount of expenditure under heads like motorcars maintained and entertainments or other attractions and amenities provided for the benefit of customers so long as they are satisfied that such amount was actually spent and no attempt was made to pass off private expenses as business expenses. It cannot be denied that in these days of competitive business, expenses have to be incurred on a more lavish scale than of old to attract and retain customers."*

Administrative discretion is however more often than not exercised against the assessee and there is much arbitrariness and injustice in a number of individual cases. Frequently, expenses legitimately incurred and necessary in the discharge of business obligations are not allowed on the ground that they are excessive or inadmissible. Among the items thus disallowed partially or completely are: *bond fide* payments to employees; bonus exceeding three months' pay even when granted by a labour tribunal; legal expenses in civil suits; legal expense in criminal complaints even when the action is successfully defended; cost of preparing accounts and of engaging accountants or counsel in income-tax or sales tax matters; advertisement expenses; expenditure of an exploratory or developmental nature; loss of trading stocks; losses by theft or embezzlement; repairs to business premises or business assets and replacements; and several other items of like

* Report of the Income-tax Investigation Commission, 1949, Part I, Para 140.

nature. Assesseees are needlessly harassed and penalised by such disallowances. It is therefore necessary to make it clear that once an expenditure is actually incurred, and if it is incurred in the course of business or is incidental thereto, it should not be treated by the Department as inadmissible unless it is established that the expenditure has been incurred collusively with the intent of defeating the revenue.

Question No. 66.—(a) Are you in favour of combining income-tax and super-tax into a consolidated levy?

(b) What are the merits or demerits of such a step from the point of view of (i) assesseees (ii) administration?

(c) Are you satisfied with the degree of progression in the present rate structure (both income-tax and super-tax) especially in regard to its economic effects?

(d) In case you consider a change is necessary what alternative rate structure would you recommend?

(e) Should the rate of surcharge levied under Article 271 of the Constitution also be graduated?

66. 1. *Consolidation of Income-tax and Super-tax.*—If income-tax and super-tax were combined into a consolidated levy and the rates expressed as a percentage of the total income, the incidence of the tax would be conveyed at a glance to the assessee who would then readily appreciate his tax liability. Likewise, the graduation of the tax would be simplified and its progression at various levels could be made smoother. The administrative work of the Department and the assesseees would also become casier as the duplication of records, orders, calculations, charges, demands, penalties, etc., would be eliminated. The principal drawback would be in relation to the super-tax on Companies, which, as corporation tax, exclusively belongs to the Centre but which on amalgamation would lose its distinctive character and become divisible between the Centre and the States.

66. 2. *The Incidence of Income-tax and Super-tax.*—The incidence of income-tax and its effects have been discussed at some length in the reply to Part I of the Questionnaire. Here it is enough to show how sharp has been the progressive increase in the incidence of the tax since the outbreak of war and how adversely the present rates in an under-developed country like India compare with those in other parts of the world.

66. 3. *Steep Increase in Incidence and Progression.*—Tables Nos. 66. I and 66. II present a historical record of the development of the tax structure since 1939-40 in relation to personal and corporate incomes. Before the outbreak of war, the maximum income-tax was at the rate of 28 1/6 pies in the case of personal incomes exceeding Rs. 1 lakh and the maximum super-tax was at the rate of 6½ annas on incomes exceeding Rs. 5½ lakhs. In the case of companies, the income-tax rate was 28 1/6 pies and the super-tax rate 13 pies. Thus, the consolidated maximum rates were 8 as. 7 ps. for individuals and 3 as. 5 ps. for companies against the current rates of 12 as. 6 ps. and 6 as. 6 ps. respectively. As Table No. 66. I shows, the tax percentage on incomes below Rs. 25,000 went up slightly in 1940-41 and 1941-42, whereafter it doubled reaching its peak in 1944-45. After a sharp reduction in 1945-46, there has been a gradual decline till the rates are now in the neighbourhood of those prevailing in 1939-40. On incomes above Rs. 25,000, the income-tax and super-tax rates rose slightly in 1940-41 and 1941-42 and flared up after 1942-43 to almost confiscatory levels for incomes in the highest brackets. The progression was made steeper every year and the confiscatory rates were applied to lower ranges, the tax being as high as 72.8 per cent. on an income of Rs. 2 lakhs in 1947-48. Some relief was given in subsequent years, but even today, the percentage tax is twice as high or more on incomes above Rs. 50,000, the graduation being extremely steep throughout.

TABLE No. 66. I.

Year	Tax as Percentage of Personal Income of Rs.								
	3,600	5,000	10,000	25,000	50,000	1 Lakh	3 Lakhs	5 Lakhs	10 Lakhs
1939-40	2.7	3.3	5.6	10.9	16.1	23.1	29.2	33.0	38.8
1940-41	2.9	3.6	6.1	11.8	17.4	25.2	31.6	35.7	42.0
1941-42	3.7	4.4	7.4	14.6	21.5	30.8	38.9	44.0	51.7
1942-43	4.6	5.5	9.0	16.9	27.7	39.2	56.0	64.5	76.8
1943-44	4.6	5.5	9.2	18.3	31.2	43.8	61.4	69.1	80.4
1944-45	..	5.5	9.2	19.3	33.7	47.7	65.1	72.2	83.0
1945-46	..	4.7	7.9	17.6	33.6	48.4	66.4	73.6	84.5
1946-47	..	3.1	5.9	15.3	32.0	47.9	71.4	80.1	88.8
1947-48	..	3.1	5.9	15.3	32.3	51.5	79.8	86.6	91.7
1948-49	..	3.1	5.9	15.3	30.8	48.3	73.5	82.6	89.7
1949-50	..	2.3	4.9	14.7	30.5	48.2	68.8	76.5	82.0
1950-51	..	2.3	4.9	12.6	29.4	47.7	66.7	71.3	74.7
1951-52	..	2.3	5.1	13.2	30.9	50.1	71.1	75.3	78.5
1952-53	..	2.3	5.1	13.2	30.9	50.1	71.1	75.3	78.5

(Source : Economic Trends, January 1953, Table A, p. 18)

TABLE NO. 66. II.

Year	Tax as Percentage of Corporate Income of Rs.							
	25,000	50,000	1 Lakh	2 Lakhs	3 Lakhs	5 Lakhs	7½ Lakhs	10 Lakhs
1939-40	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0
1940-41*	24.0	34.1	47.9	54.8	57.1	58.9	59.9	60.3
1941-42*	29.2	42.4	59.4	67.5	70.7	73.0	74.1	74.7
1942-43*	32.8	45.3	61.1	69.5	72.2	74.4	75.4	76.0
1943-44*	38.5	50.0	64.7	72.1	74.6	76.5	77.9	78.0
1944-45*	46.9	56.8	69.6	75.9	78.1	79.8	80.6	81.0
1945-46*	48.4	58.0	70.4	76.6	78.7	80.3	81.1	81.6
1946-47	37.5	37.5	37.5	37.5	37.5	37.5	37.5	37.5
1947-48**	43.8	43.8	43.8	48.5	50.1	51.3	51.9	52.3
1948-49**	43.8	43.8	43.8	43.8	45.7	47.2	47.9	48.3
1949-50**	37.5	43.8	43.8	43.8	45.7	47.2	47.9	48.3
1950-51	34.4	40.6	40.6	40.6	40.6	40.6	40.6	40.6
1951-52	37.2	43.4	43.4	43.4	43.4	43.4	43.4	43.4
1952-53	37.2	43.4	43.4	43.4	43.4	43.4	43.4	43.4

* Includes EPT.

** Includes BPT.

(Source : Economic Trends, January 1953, Table B, p. 21)

TABLE NO. 66. III.

66. 4. *Tax Incidence in India Compared with Other Countries.*—Tables Nos. 66. III, 66. IV and 66. V present a comparative picture of the tax rates in operation on personal and corporate incomes in India and other countries at the present time. Table No. 66. III reveals that the marginal rates on the top slabs of personal income are the highest in the U.K., U.S.A. and India. Table No. 66. IV (Page 204) shows the percentage of tax payable at different levels of income earned by a married assessee with two children in India and other countries. It is apparent from the Table that the progression in tax rates is steeper in India than in any other country on incomes between Rs. 20,000 and Rs. 1 lakh and that with the exception of the U.K. the tax rates are also higher on incomes between Rs. 1½ lakhs and Rs. 10 lakhs than they are in other parts of the world. Up to Rs. 5,000, the tax is at a higher rate in India than in any Commonwealth country and at any level of income up to Rs. 10 lakhs the individual assessee in India pays a higher tax than the one in the U.S.A., Canada, South Africa, Egypt or Brazil. Table No. 66. V completes the picture by comparing the taxes payable on corporate income.

Country	Year	Highest Slab over	Rate of Tax on the Highest Slab
		Rs.	Per cent
U. K.	1952-53	2,00,000	97.5
U. S. A.	1951-52	9,54,000	91.0*
India	1952-53	1,50,000	82.0
Canada	1950-51	18,32,000	80.0
France	1951-52	82,750	78.0
Australia	1951-52	1,07,700	75.0
Sweden	1951-52	1,85,185	70.0
Egypt	1951-52	6,87,500	70.0
South Africa	1950-51	2,13,333	62.9
Japan	1951-52	13,333	55.0**
Brazil	1951-52	7,77,200	50.0

(Source : Economic Trends, April 1952, Table C, p. E3).

* Average Rate Not to exceed 87 per cent.

** Average and not marginal rate.

TABLE NO. 66. IV.

Income (Rupees)	Tax as Percentage of Personal Income* of Rs.								
	India	U. K.	U. S. A.	Canada	Australia	South Africa	France	Japan	Brazil
3600	0.0	0.0	0.0	0.0	0.2	0.0	6.5	27	..
4000	2.0	0.0	0.0	0.0	0.5	0.0	7.5	28	..
5000	2.3	0.0	0.0	0.0	1.5	0.0	10.2	31	..
6000	2.6	0.0	0.0	0.0	2.8	0.0	11.5	34	..
7000	3.3	0.8	0.0	0.0	4.2	0.0	12.5	45	..
8000	4.0	2.2	0.0	0.0	5.3	0.0	13.8	50	..
9000	4.6	4.1	0.0	0.0	6.6	0.0	15.4	50	..
10000	5.1	5.8	0.0	0.0	7.8	0.0	16.6	50	..
15000	7.5	14.0	4.9	2.1	13.2	2.6	20.6	55	..
20000	9.9	19.7	8.7	5.6	18.0	4.1	23.7	55	.3
25000	13.2	23.2	11.4	8.1	22.5	6.1	25.6	55	.8
30000	18.6	27.6	13.2	9.9	26.2	9.5	27.6	55	1.5
50000	30.9	41.4	20.3	15.5	37.7	18.0	34.3	55	3.9
100000	50.1	58.2	31.6	27.3	53.7	28.4	33.9	55	9.5
200000	65.2	74.1	47.1	38.0	64.3	43.8	55.2	55	16.6
300000	71.1	81.9	56.2	43.9	67.9	54.2	61.2	55	21.5
500000	75.3	88.1	66.9	51.1	70.7	62.7	67.9	55	26.9
1000000	78.5	92.8	78.2	60.1	72.8	69.1	71.8	55	35.4

* Of Married Person with two children.

(Source : Economic Trends, April 1952, Table D, p. 15).

TABLE No. 66. V.

Country	Year	Tax as Percentage of Corporate Income of Rs.					
		25,000	50,000	1 Lakh	2 Lakhs	5 Lakhs	10 Lakhs
India	1952-53	37.2	43.4	43.4	43.4	43.4	43.4
U. K.	1952-53	50.5	55.9	61.2	63.2	63.2	63.2
U. S. A.	1951-52	33.0	33.0	33.0	41.9	49.7	52.4
Canada	1952-53	21.2	23.7	37.4	44.3	48.8	49.3
Australia	1950-51	28.7	28.7	33.4	35.7	37.3	37.9
South Africa	1950-51	20.7	21.8	22.4	22.6	22.8	23.0
Sweden	1951-52	40.0	40.0	40.0	40.0	40.0	40.0
France	1950-51	37.2	37.2	37.2	37.2	37.2	37.2
Japan	1952	42.0	42.0	42.0	42.0	42.0	42.0
Argentina	1951-52	26.5	26.5	26.5	26.5	26.5	26.5
Brazil	1951-52	10.0	11.0	11.5	12.8	14.1	14.6
Switzerland	1951-52	18.6	18.6	18.6	18.6	18.6	18.6

(Source : Economic Trends, Oct.-Nov.-Dec, 1952,

Table B, Page 16).

The rate of tax in India is not far removed from that levied in such highly advanced countries like U.S.A. and Canada. In fact, with the exception of the U.K., the rate on an income of upto Rs. 2 lakhs is higher than in any other country, and barring the U.K., U.S.A. and Canada, the rate at all levels is above that obtaining in other countries including France, Australia and Japan. It may be therefore concluded that, though the Indian economy is under-developed in comparison with those of other countries, the tax rates are excessively high and the progression far too steep.

66. 5. *Desirability of Lower Rates and Slower Progression.*—Taxation at steeply graduated penal rates is self-defeating in an under-developed country like India. It kills the incentive to produce, save and invest and stultifies capital formation which is basic requirement of an expanding economy. The rate structure, therefore, must be suitably revised. The maximum rate of tax should be substantially reduced and the level of income at which the maximum tax rate applies should be raised. Instead of 50 per cent. as at present, at least 75 per cent. should be left in the hands of an assessee as disposable income if his income is Rs. 1 lakh and the maximum rate of income-tax and super-tax combined should be about 60 per cent. on an income of, say, Rs. 10 lakhs. The rates on intermediate incomes should be suitably adjusted on the Canadian model where the tax rate is 2 per cent. on Rs. 15,000, 5 per cent. on Rs. 20,000, 8 per cent. on Rs. 25,000, 16 per cent. on Rs. 50,000, 27 per cent. on Rs. 1 lakh, 50 per cent. on Rs. 5 lakhs and 60 per cent. on Rs. 10 lakhs. These rates should not be subjected to any surcharge which, as stated in reply to Question No. 39 of Part I of the Questionnaire, should be levied only in times of national emergency as, for example, a war. As President Wilson has warned—

“There is a point at which in peace time high rates of income and profit taxes discourage energy, remove the incentive to new enterprise, encourage extravagant expenditure and produce industrial stagnation with consequent unemployment and other attendant evils.”

The war-time profits have disappeared and the war-time rates of tax cannot be maintained particularly when the economy of a country is so under-developed as it is in India. A downward revision of the tax structure is therefore not only desirable and necessary but long over-due.

Question No. 74.—Is any change required in respect of provisions relating to carry-forward of losses? Are you in favour of allowing losses to be carried backward in case of cessation of business?

74. 1. *Losses Carry-forward Provision Should be Liberalised if it is to be effective.*—Under Section 24 of the Income-tax Act, loss of profits from a business that cannot be set off against other income in the same year can be carried forward and set off against profits from the same business in any subsequent year upto a period of six years. The limitation of six years and the restriction of set off in subsequent years against profits of the same business and no other, impose severe hardships. Concerns that are newly started continue to make losses in earlier years. Continuous losses are also sustained by well-established concerns in times of

severe depression. Losing business are often closed down by assessee in favour of others which are more lucrative. It is frequently held that the business carried on by an assessee in a later period is not the same business which sustained the loss. In all such and similar cases, the assessee is deprived of the benefit of carry-forward contained in the Act. In order that the assessee may not be so penalised, it is necessary to provide—

(a) That losses can be carried forward and set off against profits of the same or any other business in a subsequent year without time limit; and

(b) That, as recommended by the Committee on the Taxation of Trading Profits in the U.K., “the owner of a business may carry back a loss incurred in the last year of business and set it against the assessments on that business for the three preceding years.”

74. 2. *Set-off of Speculation Losses Arbitrarily Disallowed.*—An extraordinary situation has been brought about by the Finance Act of 1953 in the matter of speculation losses and gains. On the one hand, speculation profits continue to be included as usual in the income of an assessee chargeable to tax. On the other hand, by virtue of a proviso and Explanations added to Section 24(1) of the Income-tax Act, it is sought to provide that speculation losses cannot be set off against the income of an assessee except against speculation gains. The legal implications of the amendment in the form it stands seem to be open to challenge and will no doubt be challenged at the proper time and place. However, the repercussions from the business point of view are so serious and widespread that the subject calls for some comment.

74. 3. *Object Underlying the Change.*—The object of the amendment was to check the practice of buying up speculation losses. The losses so bought were utilised as a set-off against the true income of an assessee, thereby reducing his liability to tax. The malpractice had gained prominence during the war and post-war period. The amendment was, however, brought forward at a time when the opportunity and the inclination to buy up speculation losses on any large scale were significantly absent. The fabulous boom-time profits were at an end and so also the expropriatory demands of income-tax, super-tax, E. P. T. and B. P. T. At any rate, in trying to check a questionable practice care ought to have been taken to see that unparalleled handicaps and difficulties interfering with the conduct of normal business were not introduced, as that would lead to harassment of honest tax-payers and penalise legitimate trading activities. Even as it was, the Department had adequate powers, by a thorough investigation and strict scrutiny of accounts and returns, to check and prevent abuses of the kind which the amendment was designed to counter-act. That, in fact, it could be done was openly admitted by an experienced Assistant Commissioner of Income-tax from Bombay who participated in the conference which the representatives of the Stock Exchanges and other associations had with the members of the Central Board of Revenue. The members of the Central Board of Revenue were themselves not concerned to deny the

position. They disclaimed any knowledge of the working of Stock Exchanges and other forward markets. They were obviously unable to appreciate the practical repercussions of the amendment proposed; nor was it possible for them to justify the necessity of such an extraordinary provision. Their sole reliance was on a vague reference to a recommendation said to have been made by the Income-tax Investigation Commission. That recommendation, as shown in Para. 74. 5 below, was altogether different from what the amendment proposed. It was in these extraordinary circumstances that the amendment was rushed through without any proper consideration. The reasoned advice of the entire business community was ignored and scant regard was shown for the enormous hardships and difficulties imposed on assesseees in the normal conduct of their day-to-day activities, particularly in the case of assesseees engaged and interested in buying and selling stocks and shares on Stock Exchanges recognised and regulated by Government itself for purposes of forward trading.

74. 4. Extraordinary Nature of the Amendment.—In one fell swoop, the amendment set at nought the basic scheme of the Indian Income-tax Act. The Act amalgamates five separate heads of income classified according to source and puts them on a composite and cumulative basis for purposes of determining the tax liability of an assessee. This scheme conforms to the generally accepted principle that income, profits and gains, no matter what their source, really accrue to one and the same person and should be treated as a single unit for taxing purposes; and that, by the same token, if a loss is sustained under any of these heads, it should also fall in the common pool to be set off against other income, profits and gains. The underlying principle, which is common to all income-tax codes, is grounded on fundamental considerations of justice and equity, and in its operation it has successfully safeguarded the interests of the assesseees as well as of the public exchequer. The amendment cuts athwart this very basis of the Act. It creates a new artificial overall category of income—speculative as distinguished from non-speculative: what is more extraordinary, it includes speculation profits in income chargeable to tax but excludes speculative losses from computation except as a set off against speculation profits. It ignores the essential fact that speculation losses, as much as non-speculation losses, have to be borne by and met out of the resources of one and the same assessee. In attempting to give the exchequer the best of both worlds, the *bonâ fide* assessee is put at the other end and made to suffer the worst: and in the process legitimate trade activity and the means, methods, and machinery of business have been rudely upset and their capacity to earn the income which is the subject matter of the tax has been crippled.

74. 5. Distortion of Income-tax Investigation Commission's Recommendation.—It is necessary to observe that there is nothing in the amendment which has the effect of restricting its application to "bought speculation losses" only. It applies to all speculation losses. Profits and gains, whether from speculation or otherwise, imply something in the nature of a credit and debit account in which the receipts appear on the one side and the costs, expenses, damages and losses appear on the other side. Without such account, it would be impossible to ascertain whether there are really any profits on which tax can be assessed. In this connection, business expenses must be distinguished from business losses. Business expenses may, by a special provision, be disallowed. But losses which are part and parcel of, and not merely connected with, the business cannot be so disallowed. Business profits and business losses which both spring up, as it were, from the same source or fountainhead, are essentially integral and indivisible in character. The one cannot be distinguished from or treated differently than the other. If speculation profits are included in the income of an assessee chargeable to tax, speculation losses must also be included. If speculation losses are excluded from the scope of the income chargeable to tax, speculation profits must likewise be excluded. That, in fact, was the exact recommendation of the Income-tax Investigation Commission on the basis of which the amendment was alleged to have been brought forward. The Commission's recommendation was distorted out of its true shape and proportion. One part of it—that relating to exclusion of speculation losses—was implemented; the other reciprocal part, namely, that speculation profits should also be excluded, was deliberately ignored. The fact was also deliberately ignored that if speculation profits are included in the chargeable income and if speculation losses, when suffered, are excluded, it would amount to charging tax on losses, which is contrary to the fundamental object and schematic structure of the Income-tax Act and contrary to equity and accepted commercial principles. An unheard of discrimination has thus been perpetuated against a particular category of trade and a particular category of income—a discrimination without parallel or precedent in procedure and practice in the taxation laws of any other country in the world.

74. 6. Some Harmful Consequences.—The whole principle underlying the amendment is mischievous, unjust and inequitable; its effects are no less so. It directly hits at business initiative. Enterprise depends upon the capacity to bear losses and the capacity to bear losses is destroyed when the losses that are normally set off against income from other sources are disallowed. For example, who would make a speculative purchase of shares of new companies subject to all the pioneering risks of new ventures when the speculation losses arising therefrom are disallowed and not permitted to be set off against other income? Likewise, normal business on the Stock Exchange stands to be adversely affected. People become disinclined to enter the market because their capital resources are likely to be exhausted when the loss they suffer is not allowed to be set off against other income. For instance, an assessee may conceivably make substantial profits from different non-speculative sources. He may however lose so heavily in the stock market that he has an over-all deficit. In that event, how can he pay the large amount of tax that is bound to be demanded of him when the set-off of speculation losses is disallowed? The amendment proceeds on the erroneous and fallacious assumption that all business in which delivery is not taken or given is necessarily speculative and that all business in which delivery is taken or given is necessarily non-speculative. Assesseees frequently enter into forward contracts for *bonâ fide* business purposes and decide only when the contracts mature whether to take or give delivery or cover the transaction by paying the difference. Similarly, assesseees often arrange to take delivery in respect of admittedly speculative business. On the Stock Exchange particularly, the speculative and non-speculative inter-penetrate so completely that any artificial distinction between them is both arbitrary and unjust. By enforcing a rigid dichotomy, the amendment sets up artificial compartments between which there is one-way traffic only, from the non-speculative to the speculative, but not the other way about. Risks and hazards are inseparable from the Stock Exchange, and when those who come to the market are not allowed to set off their speculation losses against their other income, the trade as a whole is seriously affected. A few examples may be cited. For instance, when non-member assesseees engage in jobbing business, the profit earned is added to the other income and tax has to be paid on the full amount and at the rate applicable to that full amount. When, however, the jobbing transactions result in a loss, there is no set-off or rebate of tax. A stockbroker wishing to insure himself against the risky business accumulated by his constituents may enter into corresponding hedge transactions by buying or selling on his own account in the market. If profit accrues therefrom, it is amalgamated with the other income and charged to tax. But when such hedging results in a loss, it is not admissible for determining the tax liability. From time to time, a stockbroker nurses the securities bought for forward delivery for his defaulting constituents with a view to reducing the losses sustained. He 'nurses the baby', and if there is a profit it becomes liable to tax, but when there is a loss it cannot be set off against other income. A trader or dealer or crusher of groundnut or linseed or any other oilseeds hedges his stocks or open purchases or sales by utilising the only medium available, namely, the castor-seeds hedge contract. The profit accruing from such hedge is added to the aggregate income of the assessee chargeable to tax, but if a loss be suffered, it cannot be deducted. One can go on enlarging the list, for 75 to 80 per cent. of the business on the Stock Exchanges and in other forward markets is allegedly speculative within the meaning of Section 24 (1) of the Act so that 75 to 80 per cent. of the *bonâ fide* trade and discriminated against and drastically penalised. The question in each case is, is this fair, equitable or reasonable? The disability attaches not to the few tax-dodgers only but to all assesseees one after another, to the big broker and the small authorised representative, to the wealthy merchant, the middle-class trader and the professional operator, to the financier who lends money to the market and to the man-in-the-street whose handful of orders to buy or sell this or that actually makes the market and keeps it broad and liquid. It is submitted that what seems to have been forgotten is that the Income-tax Act is a measure primarily designed for collecting revenue; that it is unwise to turn it into an engine of oppression damaging *bonâ fide* business and legitimate trade in a Draconian attempt at checking leakage of revenue, which is what is now happening; that unless there is trade and business, there will be soon little by way of profits to tax and less by way of revenue to collect.

74. 7. Futility of the Amendment.—The principal object with which the amendment was introduced was to protect revenue by checking the malpractice of buying and selling of losses. During the debate in Parliament, the Finance Minister admitted that there was no direct way of defining, or legal purposes, these particular transactions. He then went on to explain as

under how the amendment was to be made workable at all:

"We have proceeded by the method of excluding what we do not want to hit. In the Bill as it is drafted we have excluded hedging transactions, the common hedging transactions, that is a mill buys cotton and sells cloth. There are various other varieties of hedging transactions, and after discussions with the representatives of trade and business I have come to the conclusion that they are also legitimate. One category of transactions is the one I referred to just now: a man wants to protect himself against any loss in certain scrips he holds, but he sells some other scrips which he expects will have a reverse movement. The object is to save that kind of transaction."

This correctly sums up the *modus operandi* of hedge transactions in forward markets. A holder of shares in one company anxious to protect himself against losses through price fluctuations generally sells other scrips which are current as a hedge and are freely marketable and negotiable. If a person holds shares of, say, Mysore Mills which at a particular moment do not have a ready market, he hedges by selling, say, Tata Steel Defts. or Bombay Dyeing which may then have a liquid and broad market. Big mercantile houses, by the very nature of their business, have to resort to such transactions by selling popular scrips to guard against losses in their holdings which they generally keep as a locked-up investment, either because there is no market for such shares, or for retaining control of the Companies concerned, or for future capital appreciation. It is a fundamental object of the forward market in shares to provide a hedge to the genuine investor as well as a free and ready market for shares. A provision for this is made, as the Finance Minister explained to the House, by insertion of Clause (b) in the proviso to Explanation 2 to Section 24(1) of the Income-tax Act. There is no doubt that Stock Exchange losses suffered by an assessee when hedging against his investment are excluded from the definition of "speculation loss" and can be set off by him against his other income. The question, what would happen if such losses were disallowed has been already answered by the Finance Minister in his speech quoted above. The further question is that if such losses must necessarily be allowed—which is what clause (b) provides—, what is there to stop unscrupulous wealthy assesseees who have large investments of their own from 'buying losses' in the guise of hedge transactions against their investments and then claiming a set off? The amendment to Section 24(1) is supposed to cast a net especially for catching such tax-dodgers, but in fact the mackerel escape and only the sprat are caught. What then is the meaning of the amendment to Section 24(1)? There is no way of steering clear between Scylla and Charybdis. The fallacy lies in the presumption that the entire complicated trade of various forward markets can be defined in law by a process of exclusion through the insertion of some exceptions here and there. The addition of exceptions capable of giving some protection to *bona fide* trade inevitably make the amendment leak like a sieve; and without such exceptions, the trade itself is greatly disorganised. In the result, honest assesseees receive the short end of the stick in either case. The amendment to Section 24(1) with its clumsy and ambiguous provisions hits *bona fide* business at all points and probably the only person who is not worried is the tax-dodger 'buying losses'.

74. 8. *Harassment of Assesseees.*—It has been claimed for the amendment that it is designed to serve administrative convenience in checking the malpractice of buying and selling losses. Its futility as a check on the malpractice, to the extent that it does prevail, has been demonstrated in the preceding paragraph. Nor is it true that the amendment is capable of serving any administrative convenience. On the contrary, it widens the field of enquiry by the Income-tax Officer and opens one more door for harassment of assesseees. Anyone who has had anything to do with the Income-tax Department can easily imagine what is actually bound to happen. For example, as pointed out in Para. 74. 6, the transactions purported to be defined as speculative and non-speculative by the amendment inter-penetrate as completely as to make any artificial distinction between them entirely arbitrary. The assesseees must now attempt to separate out the speculative from the non-speculative transactions, trace the chain in each case and show how they are related to delivery and payment, and when a loss is sustained, allocate it in parts which either can be or cannot be claimed as a set-off under the amendment. In the end, the assessee may succeed in satisfying the Income-tax Officer that there is no speculation loss or that such loss is covered by the exemptions. But before that is done, he will be obliged to produce heaps of books and files and pay several visits to the Department, not to speak of the expenses incurred in representation through expert advisers. Apart altogether from the view the Department ultimately takes when settling the assessment, the assessee is confronted with an infinite variety of circumstances in which he must decide on the spur of the moment as

to how he should act. Obviously, the situation is intolerable when at each step he is expected to stop and think of the view the Department may or may not take of the nature of the transactions in question when they come up for consideration in the course of assessment two or three years later. The fact that the Income-tax Act by a legal fiction empowers an Income-tax Officer to say that a particular loss is speculative and that its set-off cannot be permitted does not put back money in the pockets of an assessee to enable him to pay the tax demanded. The disallowance of the set-off of losses in respect of 75 to 80 per cent. of the *bona fide* trade of forward markets, which in one sense or another might be held to be speculative, can only cause harassment and impose a hardship and burden for which there is no sanction either in equity or justice and no warrant in the needs of the situation. It is for this reason that the amendment to Section 24(1) is condemned by all quarters as misconceived and mischievous, as needlessly provoking unhealthy litigation and upsetting the trade while failing in its main purpose of stopping the malpractice of 'buying losses', to the extent that it does prevail at present.

74. 9. *The Correct Approach.*—The coercion implicit in disallowing set-off of speculation losses is calculated to diminish speculation gains which ultimately give assesseees their livelihood and are the source from which Government revenue itself is derived. If that source is considered tainted, there is no object in Government regulation of forward markets. But to recognise, on the one hand, the importance of forward markets, and on the other to disrupt their efficient functioning by slowly garrotting *bona fide* forward trade through the medium of the Income-tax Act, is a contradiction in terms which cannot be easily reconciled. It is necessary to emphasise that the problem of buying speculation losses is quite capable of being solved by normal processes. No doubt it is true that losses do not bear on the surface any marks of their origin. But they become significant from the point of view of income-tax evasion only when—

- (a) an assessee claims set-off of speculation loss against other income;
- (b) the assessee's other income is large; and
- (c) the proportion of speculation loss to the other income is large.

Such cases can be picked out at sight and this at once limits the field of critical investigation to a relatively small percentage of the total number of cases. Any extra expense and attention devoted to such cases is likely to be well rewarded. A determined tax-dodger may be expected to do his best to obliterate all evidence of the origin of the losses he has bought. But the operation can be carried out only with the collusion of a number of other parties and by the fabrication of books and documents at a number of places with the sword of Damocles hanging over his head in the form of threats of exposure and blackmail. In fact, where an organised market like the Stock Exchange is concerned, such an attempt all the way can rarely succeed. When the purchase and sale contracts resulting in the alleged loss are not found to be supported in the books of the brokers employed by the suspect assessee in the shape of corresponding transactions in the open market with other 'Bazaar' parties, that is, broker brokers, that should be deemed to be *prima facie* evidence that the loss claimed is not genuine, unless indeed the assessee produces irrefutable evidence to the contrary. It should not be difficult to educate a hand-picked staff in the *modus operandi* of 'buying losses', and with such a staff in charge of the small number of suspect cases, the fraud on revenue cannot for long survive. The problem is essentially one of a vigilant, efficient and honest administration. The responsibility for that must rest with the Department and cannot be saddled on the shoulders of an overwhelming majority of honest assesseees who are interested or engaged in forward business.

74. 10. *An Indictment.*—It is clear from the foregoing that the amendment to Section 24(1) should not have been brought forward at all. Merits apart, the manner of its enactment into law reflect no credit on the administration responsible for putting it on the statute book. The amendment was first mooted in the Income-tax Amendment Bill, 1951. Its object was then stated to be to—

"Check a tendency on the part of assesseees to claim speculation losses but not to admit speculation profits."

The explanation was *prima facie* untenable and it indicated some serious confusion in the mind of the Department. Obviously, it would be foolish for an assessee claiming speculation losses not to admit his speculation gains. The amendment, however, lapsed with the Bill. Later, the Indian Income-tax Bill (No. 35 of 1952) was introduced in Parliament on the 20th of May, 1952. The new Bill, which was admittedly confined to proposals to give effect to some of the urgent and clarificatory provisions among those embodied in the Amendment Bill of 1951; contained no reference to the amendment to Section 24(1). Government itself stated that those

provisions of the 1951 Bill which were not included in the 1952 Bill required detailed examination in the light of the comments received from various quarters. It was when this urgent 1952 Amendment Bill was still pending before the House, when no new development had occurred after its introduction and when no material change in the circumstances had taken place, that one of the most controversial amendments appearing in the 1951 Amendment Bill, namely, the amendment to Section 24(1) of the Income-tax Act, was revived. It was smuggled in, as it were, by the backdoor in the form of Clause 3(d) in the routine annual Finance Bill placed before the Budget session of the House at the end of February 1953. At about the same time, when dealing with suggestions made in the House for changes in the Income-tax Law, the Finance Minister reportedly declared in the course of his reply to the debate on the general budget that—

“There was also another reason why they should not make any fundamental changes in the taxation structure in the coming year. A Taxation Enquiry Committee has been appointed to go with the matter comprehensively.”

Here was an example of practice and precept. The House was further deluded. The Hon'ble Minister in his Budget Speech, in referring to the proposed amendment to Section 24(1) observed that—

“The Income-tax Investigation Commission recommended that the law should be amended so as to allow speculation losses to be set off against speculation gains.”

Apparently, the Finance Minister was unaware of the Income-tax Investigation Commission's reciprocal recommendation that along with speculation losses speculation gains should also be excluded when determining the income of an assessee chargeable to tax. The Commission's recommendation was contained in the confidential part of its report to Government, of which the public or the Parliament had no knowledge. The House remained in the dark about this most important part of the Commission's recommendation and the public was misled. Nor was any reasonable opportunity afforded to the business interests vitally affected to explain themselves satisfactorily and convince the administration not acquainted with the technicalities of forward trade, of the serious repercussions of the measure proposed. Soon after the publication of the Finance Bill, the Stock Exchange submitted its representation to Government on the 5th of March, 1953. Other business bodies, chambers of commerce and trade associations followed suit, pointing out the inequity and inadvisability of the amendment and its harmful consequences. There was little response to these representations, not even an acknowledgment. Only after urgent reminders was a telegram received by the Exchange on the 6th of April, 1953, exactly after the lapse of one full month, inviting its representatives to meet the Central Board of Revenue in conference for an hour and then proceed to an interview with the Finance Minister. The representatives of other associations were also invited simultaneously. With so many points of view to present, there was little time for a considered discussion. The members of the Central Board of Revenue were courteous and kind but their mind was fully committed to the amendment due for debate in the House in the course of the next day or two. As mentioned in Para. 4.3 above, the members of the Central Board of Revenue disclaimed all knowledge of the working of forward markets; they were also singularly unconcerned about the practical implications of the measure proposed. They hinted vaguely at large losses of revenue; but they were unaware of or unwilling to disclose the number of assessees involved and the period to which such losses related—whether the reference was to a recent year or to the war and post-war years, and whether it covered a single year or a series of years. The members of the Central Board of Revenue were also unable or unwilling to explain how, if the revenue lost through fictitious losses could be estimated, the assessee themselves could remain undetected and the offenders not punished for fraud under the sweeping powers vested in the Department, if the administration was at all vigilant, efficient and honest in the discharge of its functions. The main reliance of the Central Board of Revenue remained on the recommendation alleged to have been made by the Income-tax Investigation Commission. That the vital complementary part of the recommendation had been omitted only came to light subsequent to the interview with the Finance Minister. Torn between the exacting demands of a House in session on the one hand and of high pressure budget work on the other, the Finance Minister was generous enough to forego some of his lunch time to carry on the discussions with the representatives of trade and commerce on the complicated issues arising out of the amendment to Section 24(1). In spite of the rush, he was able to appreciate at least some of the hardships which were later sought to be remedied by adding a few hastily worded exemption clauses to the main amendment. For the rest, he felt that in the brief time at his disposal he would have to be guided

by the expert advice of the Central Board of Revenue, whose members were however candid enough not to pretend to any knowledge of forward trading. At the same time, the Central Board of Revenue was not even prepared to take out the amendment from the Finance Bill and introduce it as an additional clause in the Indian Income-tax Bill, 1952, then pending before the House so that the data and recommendation on which the amendment was purported to be based could be substantiated and verified and the complex and complicated issues arising therefrom thrashed out in the normal fashion with Government and, if necessary, before a Select Committee. Instead of agreeing to this simple suggestion from which there was everything to be gained and nothing to be lost, the amendment was put up before the House a day or two later and subsequently carried through with a few modifications. A reasonable opportunity of enlightening the authorities and Parliament about the true nature and meaning of the proposed amendment and of a critical examination of the actual facts and possible alternatives, was thus studiously denied. The omission of the amendment from the appropriate 1952 Income-tax Amendment Bill, its sudden inclusion in the 1953 Finance Bill, the unusual delay of over one month in granting a hearing to the representatives of trade and commerce, the single day left for discussion and elucidation of so controversial a measure before its consideration by Parliament then in session, the steadfast refusal of the Central Board of Revenue to extend the time for consideration or substantiate its data, the perversion of a recommendation confidentially made to Government by the Income-tax Investigation Commission, the misleading references to that alleged recommendation and the reliance thereon in preference to suggestions for awaiting the findings of the Taxation Enquiry Commission, the melodramatic haste with which the amendment was rushed through the House without even a vestige of urgency to justify that procedure: all these were of a piece with the amendment itself—unjust, unfair and inequitable, repugnant to recognised canons of taxation and callous to the harassment and hardship caused to *bona fide* trade and a large body of innocent assessees. 75 per cent. to 80 per cent. of the business on the Stock Exchanges and other forward markets being allegedly speculative within the meaning of the amendment to Section 24(1) of the Act, 75 per cent. to 80 per cent. of the *bona fide* trade and the assessees interested or engaged in such trade are penalised for the misdeeds of a handful of tax-dodgers in a manner without precedent in income-tax law and practice in the past and without parallel in any other part of the world. This is a great wrong. It is submitted that the wrong must be righted by rescinding the amendments made in Section 24(1) of the Income-tax Act by Section 3(d) of the Finance Act, 1953.

Question No. 75.—Do the provisions relating to the payment of advance tax under section 18A of the Income-tax Act need any modification?

75. 1. Advance Payment of Tax Should be Abolished.—Section 18A was introduced during the war as an anti-inflationary measure. It has outlived its purpose and should be repealed. The continuance of the Section in present day conditions causes considerable hardship, particularly when the business is of a fluctuating nature as of a broker assessee. Large losses are liable to be incurred unexpectedly involving equally large and unexpected demands on capital resources. When profits have been earned in the earlier period, the tax has to be paid in advance if the penalties are to be avoided. Subsequently when the profits are wiped out by reason of losses sustained in the normal course of business, the amount paid as tax in advance becomes blocked and is not available to the assessee though he is sorely in need of funds. In the current restrictive conditions when credit is difficult and costly to obtain, the assessee is obliged to seek financial accommodation while his own capital is locked up to no purpose. The hardship inflicted is obvious. The hardship is accentuated because the Department having secured payment of the tax in advance is not inclined to complete the assessments which are kept pending for a long time. The heavy arrears in respect of assessments are a measure of the burden thus wrongfully imposed on assessees. Though revenue is being collected expeditiously, there is no doubt that the assessees are being subjected to intolerable harassment and delays and their patience and resources are tried almost beyond the point of endurance. Section 18A should therefore be repealed.

75. 2. Simple Provision More Suitable.—Instead of Section 18A, a simple provision should be substituted requiring assessees to pay tax, within three months of the date of submission of their income-tax returns, on the basis of the income as computed by them, subject to adjustment when the assessments are finally completed. This will ensure timely realisation of revenue and at the same time a source of crying injustice and dissatisfaction will be removed. The assessees will not suffer the present hardships which have become almost unbearable and the Department will be more alive to its

responsibilities and to the duty it owes to assesseees in the matter of quick and expeditious completion of assessments which are now kept pending for years.

Question No. 78.—*It has been suggested that the Appellate Tribunal should have powers to enhance assessments in the same manner as Appellate Assistant Commissioners have. What is your opinion?*

78. 1.—Appellate Tribunal Should have No Power to Enhance Assessments.—The Appellate Assistant Commissioner is seized of the power to enhance assessments on appeal on the most unsatisfactory ground that an Income-tax Officer cannot appeal against his own order. Even this unconvincing argument cannot be advanced where the Appellate Tribunal is concerned, as both, the assessee as well as the Department, are free to prefer an appeal if they so desire. The Appellate Tribunal has appellate and judicial functions to perform and it should therefore have no power to enhance assessments. In fact, by the same token, Appellate Assistant Commissioners should also have no power to vary in favour of the Department an order under appeal because the Commissioner of Income-tax possesses wide powers of revision which can always be invoked when an improper revision which can always be invoked when an improper

Question No. 79.—*Do you recommend that an element of progression should be introduced in the corporation tax?*

79. 1. Hybrid Character of Company Super-tax or Corporation Tax.—The dual appellation of Company super-tax, alternatively called corporation tax, is an index of its hybrid character. It is generally regarded as being in the nature of income-tax; others contend that it is a tax levied on corporations as such, although calculated by reference to income. There are inconsistencies in the present position on either view.

79. 2. Characteristics of a Corporation Tax.—Companies are separate legal entities enjoying certain unique privileges such as limited liability and perpetual existence irrespective of the changes in the ownership of their shares. It is claimed that the corporation tax is a payment for these privileges. If that be so, the tax should not be levied on the profits of the Company because, as the Income-tax Enquiry Committee (1924-25) acknowledges,—

“Small companies derive relatively as much advantage as large ones from the privilege of incorporation.”*

Further, even if the tax be so levied, the Income-tax Enquiry Report (1936) admits that—

“It should be allowed as a deduction in computing the profits of a company for income-tax purposes, as was the case with the United Kingdom Corporation Profits Tax.”**

No such deduction is, however, allowed. Even the historical development of the tax lends no support to the view that it is a tax levied on the special privileges of incorporation. This notwithstanding, the tax continues to be in force as if Companies were separate objects of taxation with a separate taxable capacity of their own.

79. 3.—Characteristics of Super-tax.—The view more generally put forward is that the super-tax on companies is not based on any special ability but is essentially in the nature of an income-tax. In fact, the charging Section 55 of the Income-tax Act describes it as “an additional duty of income-tax”. If this fact is recognised, it becomes clear that the tax must be levied with reference to its incidence on the shareholders who are the ultimate owners and recipients of the corporate income. As the personal income of individual shareholder attracts tax at varying rates, it follows that there should be a provision for refund of super-tax if the personal rate of a shareholder is lower than the Company income-tax and super-tax rates combined and that there should be a tax credit when the personal rate is higher. However, as is well known, no such refund or credit is allowed to assesseees in respect of the super-tax paid by companies of which they are the shareholders.

79. 4. Inequities of the Present System of Company Taxation.—The present system of taxation falls between two stools and the shareholder assesseees have the worst of both worlds. On the one hand, the company super-tax is not allowed as a business deduction, as a corporation tax should be; on the other hand, though based on profits, there is no provision for refund or credit of the super-tax actually paid. In fact, the inequity goes deeper. The entire system of deducting income-tax at source and charging super-tax or corporation tax represents an attempt at taxing undistributed corporation profits on some rough and ready basis. In the process, two serious anomalies arise:

(a) First, such undistributed profits are charged to income-tax at the maximum rate and to

super-tax or corporation tax at a flat rate, irrespective of the personal rates applicable to the shareholders to whom the profits really belong and irrespective of whether such shareholders are at all liable to pay any super-tax or even income-tax.

(b) Secondly, in respect of the distributed corporate profits, shareholders who are not assessed to super-tax or even income-tax because of their small personal incomes are nevertheless subject to a special super-tax on their dividend income and those within the super-tax brackets become liable to pay a double super-tax.

The general incidence of income-tax and super-tax are thus basically affected. A relatively poor assessee, deriving a part or the whole of his income from company dividends, has to pay as high an income-tax (at the maximum rate) and super-tax on the undistributed profits and as high a super-tax on the profits distributed as dividend in respect of a company of which he is a shareholder as has to be paid by another shareholder who may be the wealthiest of assesseees, though he would neither have to pay super-tax nor even income-tax were his income otherwise derived. Nothing could be more burdensome or inequitable. These defects taint the case of all shareholder assesseees and the burden becomes heavier and the inequity more pronounced as the proportion of dividend income to the total income increases. Fair progression of the tax is destroyed, and instead of the tax varying with the amount of the income earned, it varies according to the ratio of the assessee's dividend income to his total income. The company income-tax and super-tax therefore operate in flagrant breach of the canons of equity and ability to pay. The effects of this system go much further. As Dalton points out—

“It discriminates against a particular class of property owners, namely the ordinary shareholders in joint stock companies, as compared with all other classes, including debenture holders and the holders of war loan and other gilt-edged securities. It is, therefore, in effect, a tax on risk-bearing and tends to divert the flow of capital from risky to comparatively safe investments. But, in view of the need that risks should be taken and the reluctance of many investors to take them, this is a harmful diversion.”*

79. 5. Company Super-tax—Not Graduation But Abolition.—It has been shown that the corporation tax or company super-tax, by whatever name called, offends against well-recognised principles of equity and ability even in its present form. Graduation of the tax would worsen the position. There is no justification for companies with small profits paying less than those with large profits. As the Income-tax Enquiry Committee (1924-25) observes—

“The amount of profit made by a company bears no necessary relation to the wealth or poverty of its shareholders.”**

Rich assesseees are as likely to hold shares in Corporations making small profits as assesseees not so well off are likely to hold shares in Corporations making large gains. It is an obvious fallacy to equate the size of a company's income with the size of the incomes of its individual shareholders, and fundamentally, graduation of company super-tax proceeds on no other assumption. If the proposal were accepted, the existing maldistribution of the tax burden would be incalculably increased. The Income-tax Investigation Commission therefore reaches the following conclusion:

“Public companies generally attract a large number of middle class shareholders and many of them would be seriously prejudiced if the companies are subjected to super-tax at a progressively increasing rate. If such super-tax is levied, it will not be fair to exclude the application of Section 49-B in such cases.”†

Herein is a tacit admission of the inequity that now obtains and of the discrimination practised against joint stock enterprise on which so much of the progress and advancement of the country's under-developed economy ultimately depends. The arguments against graduation of economy super-tax are, basically, nothing more and nothing less than arguments against the entire system of company taxation itself. It follows that at least the company super-tax or corporation tax should be abolished. If that is not feasible, in any event the following provisions should be made; namely—

(a) Shareholders should be entitled to claim credit or refund in respect of income-tax as well

* Dalton, Principles of Public Finance, Ch. X, Para 11, pp. 99-100.

** Report of the Income-tax Enquiry Committee, 1924-25, Ch. IX, Para. 251.

† Report of the Income-tax Investigation Commission, 1949, Part I, Para. 84.

* Report of the Income-tax Enquiry Committee, 1924-25, Ch. IX, Para. 251.

** Income-tax Enquiry Report, 1936, Ch. II, Sec. 3, p. 18.

as super-tax deducted at source on dividends received by them; and

- (b) The amount of income-tax and super-tax paid by Companies on their undistributed profits should be allowed to be deducted as a business expense when determining the incomes of the companies chargeable to tax.

Question No. 81.—*There is a demand for the exemption of inter-corporate dividends from corporation tax. Do you consider this justified and, if so, why?*

81. 1. Inter-corporate Dividends Should be Exempt from Corporation Tax.—It has been suggested in the answer to Question No. 79 above that all shareholders should be entitled to claim credit or refund of company income-tax and super-tax on the dividends received by them. It follows that the reason is all the greater for exempting inter-corporate dividends from corporation tax. A company pays super-tax on its own profits, and if such profits are composed of dividends of other companies which have already borne corporation tax, there is double taxation unless the dividend income is exempted in the hands of the receiving company.

Question No. 84.—*Do you think, in view of the fact that profits distributed by a company are subjected to corporation tax, it is appropriate that they should also be charged to super-tax in the hands of shareholders? If not, what are your suggestions in this regard?*

84. 1. Corporation Tax and Double Taxation.—The point has been dealt with in the answer to Question No. 79 above. Corporation tax invariably imposes an extra tax on the assessee irrespective of whether he is in the super-tax bracket or otherwise.

Question No. 85.—*Would you consider that industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies should be required to contribute, from their earnings in the way of income-tax or in other ways, to general revenues?*

85. 1. Public Undertakings Should be Subject to Same Taxes as Private Enterprise.—As explained in the answer to Question No. 10 in Part I of the Questionnaire, industrial, commercial and similar other enterprises undertaken by the Centre, the States and local Bodies should be subject to all the taxes, including income-tax, which are levied on private enterprise. Otherwise, private enterprise will be discriminated against and will find itself at a disadvantage as its competitive capacity will be artificially reduced. Uniform taxation will ensure conditions of fair competition. The payment of tax by enterprises managed by public authorities will not make any difference to the tax payers, for the tax paid will be more or less a transfer from one pocket to another. One important point, however, will have been gained. It will prevent concealed subsidisation by the Central Government of enterprises managed by public authorities and provide a ready check on the relative efficiency of private and public undertakings engaged in the same business or in similar activities.

Question No. 91.—*Do you think that, in order to minimise evasion and avoidance of tax, there is a case for conferring larger powers on income-tax authorities? If so, what further powers should be given to them? In particular, should powers to search premises and seize documents and books of accounts be given to Income-tax authorities? If so, what is the lowest grade of officer on whom you would confer these powers?*

91. 1. Present powers of Income-tax Officers Adequate.—The Income-tax Officers are seized of sweeping powers at present and these powers are more than adequate to minimise evasion and check tax avoidance. There is no occasion for conferring larger powers of the nature described as they will only prove to be additional instruments in the hands of the Department for harassing innocent assessee. The better method would be to exercise greater supervision, improve the general efficiency and weed out graft and corruption which are said to be rampant in one form or another.

Question No. 97.—*What Concrete measures should be taken to improve the relations of the Income-tax Department with assessee, especially in regard to—*

- (i) provision of free advice to small assessee on the following points:
 - (a) maintenance of accounts in a form acceptable to the Income-tax Department; and
 - (b) matters such as filling returns of income, claiming refunds, facilities for tax payment, expeditious disposal of assessments, etc.;
- (ii) provision of information on various matters relating to assessment proceedings, such as disposal of refund applications, adjournment applications, examination of records, etc.;

(iii) arrangement of work so as to obviate the necessity of assessee or their representatives having to wait in Income-tax Offices for unduly long periods; and

(iv) securing of the largest measure of agreement on facts between the assessee and the department at Income-tax Officer level?

97. 1. General Complaints regarding Income-tax Administration.—The general complaints regarding income-tax administration are almost of a chronic character. The assessee are subject to trouble and harassment varying from pin-pricks and minor discourtesies to harsh and vindictive treatment. The point has been dealt with in answer to Question No. 15 in Part I of the Questionnaire. It is a matter of the tone and temper of the administration and the environment which it creates, the cumulative effect of which gives rise to the present acute dissatisfaction.

97. 2. Slackness and Inefficiency.—It is a matter of common observation that slackness, inefficiency and dilatoriness prevail in the Department. Letters remain unanswered, reminders are ignored and even acknowledgments are not forthcoming. The Income-tax Enquiry Report, 1936, observes:

"The fairly general complaint that the Income-tax Officers do not show enough consideration for the convenience of the assessee is certainly not without foundation. For instance, notices are issued for the attendance of a number of assessee on the same day and at the same time, and we have seen a group of them waiting with indifferent accommodation when the office opened to the public, and many of them still waiting when the office closed for the day. We have also seen cases in which, apparently without reasonable cause, assessee were given only 24 hours' notice to attend at the Income-tax Office to produce evidence, and others in which books were called for and retained for some days pending their examination."*

The position has improved a little but in the main the grievances remain. There is frequent failure to keep appointments given to assessee, involving gross waste of time. It is not unusual to be told that papers are missing or that files cannot be located. The filing system is ante-diluvian and so is the entire system of office organisation. The proper allocation of work, a check to ensure the maximum output with a minimum of waste, a clear chain of responsibility and the streamlined efficiency characteristic of a modern establishment are conspicuous by their absence. The floors are cluttered up with papers and files, red tape and dead lumber choke up efficiency and an assessee making inquiries or requiring assistance is pushed from pillar to post. The Income-tax Investigation Commission therefore endorses what a writer on "Public Finance" has observed that—

"Bureaucratic indifference of the tax administration is the most common cause of inconvenience to the tax-payer."**

97. 3. Troublesome Requisitions.—The Department is reported to be pernickety and exacting in its requisitions. The time, labour and inconvenience involved appear to be of little consequence. There is an insistence on assessee preparing and furnishing lengthy statements entailing clerical expense and waste of time even when the information is available in the account books submitted for inspection. Brokers are now and again compelled to produce numerous books of accounts or furnish long lists or elaborate statements when the assessments of their constituents are under consideration, even in matters where the statements issued by the brokers to their constituents contain the required information and could easily suffice. On occasions, books and records relating to assessments completed many years ago are called for and the inability of the assessee to produce them is held against him irrespective of the bonafides of the case. Such vexatious requisitions are a source of discontent and dissatisfaction with the working of the Department.

97. 4. Delay in Income-tax Refunds.—The delay in dealing with claims for refund has been a matter of perpetual complaint. It has been the subject of adverse comment in the Report of the Income-tax Enquiry Committee, 1936, which states that—

"The general attitude of officers of the Department to refund claims leave much to be desired."†

The Income-tax Investigation Commission devotes ten pages of its Report to this vexed question and expresses its dissatisfaction that—

"As the Inspecting Assistant Commissioners also do not seem to attach much importance to this part

* Income-tax Enquiry Report, 1936, Ch. XIV, Section 4.

** Report of the Income-tax Investigation Commission, 1949, Part I, Sec. II, Para. 19.

† Report of the Income-tax Enquiry Committee, 1936, Ch. XIV, Section 10. Para. (a).

of the work of Income-tax Officers, the arrears go on mounting much to the inconvenience of small assesseees or persons having non-taxable income.”*

The hardship inflicted on wealthy assesseees is no less great when the refund due to them from one Income-tax Circle in respect of E. P. T. or E. P. T. deposit or B. P. T. is not adjusted against the demand made on them by another Income-tax Circle which completes their ordinary assessment. It also sometimes happens that even after the assessment is completed the refund order is held back for months in spite of repeated reminders. The injustice and hardship resulting from such delays to assesseees entitled to considerable relief are clearly of a serious nature. With some planning and supervision, it should be possible to expedite the work so that the refund applications are disposed of within a month or so and the recommendations of the Income-tax Investigation Commission in this behalf deserve to be implemented with greater force and vigour.

97. 5. *Lack of Consideration for Assesseees.*—There is a general lack of consideration for assesseees on the part of the Department and at times they are treated more as criminals than as taxpayers. Referring to these complaints, the Income-tax Investigation Commission quotes** with approval the recommendation made by the Royal Commission appointed in the U.K. in 1920 that care must be taken not to harass or irritate the general run of tax-payers merely because it is necessary to deal severely with the tax-dodger. The Department however continues to be as “wooden, ill-managed, unimaginative and unjust” as before. It distrusts assesseees and regards them with a suspicious eye as if they were professional tax-dodgers. It doubts the books that are produced, rejects accounts on the flimsiest grounds and calls for records a dozen years old. It arbitrarily assesses fantastic gross profits, refuses expenses as excessive or unnecessary and disallows bad and doubtful debts as not accrued or not proved much as it takes its whim and fancy. It either enters into heavy assessments or otherwise delays assessments till they are about to be time-barred and then completes them on some arbitrary basis one on the top of the other. It then proceeds to charge penalties, demands immediate payment of accumulated dues irrespective of the position of the assessee or the finances of his business, refuses to extend the time for payment pending disposal of appeals and issues notices of attachment and payment of taxes in advance. The Income-tax Investigation Commission records these complaints as under:

“The Income-tax Officer and the system of which he is the product are held, in these replies, responsible for driving the tax-payer first to non-cooperation, then to hostility and thirdly to evasion. Incivility, incompetence, extortion and lethargy are the accusations made against the Income-tax Officer Even after making due allowance for exaggeration of language, it is evident from the replies that a strong feeling of distrust and discontent exists in the public mind against the administration of income-tax in this country.”†

The Commission's own findings tend to support the foregoing complaints. Referring to the Income-tax Officer, the Commission says—

“He is judged efficient not by the knowledge he shows or the manner in which he deals with the assesseees, but the increase he makes in the demand of tax. His approach to assessment is thus not of a fair judge but of a partisan collector of revenue We would suggest that the Income-tax Officer should be judged not on the number of heavy assessments he makes but in the number of unsuccessful appeals against his assessments; in the knowledge and understanding he shows and not on the pitch to which he raises his assessments; on the speed of his collections and not on the size of his paper demands.”‡

However, old habits die hard, and the Commission's recommendation notwithstanding, the position is unchanged.

97. 6. *Conclusion.*—There is little doubt that in the matter of income-tax administration much can be accomplished by softening the rigours and inequities of the present position. The largest single contribution in this direction would be in a change of the relationship that now subsists between the Department and the assesseees. If the Income-tax Officers were not to behave as inquisitors but as public servants charged with the duty of helping the tax-paying public, and if the assesseees

were to regard taxes not as a symbol of tyranny but as a measure of their obligation in the cooperative task of living together (which they would be more inclined to do if the taxes imposed were reasonable, fair and equitable), there would soon be an end to the countless complaints that embitter the situation today. While the necessity of educating the assesseees into this view cannot be denied, the conclusion cannot be escaped that income-tax administrators as a smaller and more specialised class clothed with many responsibilities and armed with large powers should not stand in need of such education. That is at the root of much of the current discontent. Given the right approach, as the Income-tax Investigation Commission recognises,—

“The Income-tax Officer instead of being dreaded and shunned as at present would then come to be looked upon as a friend and a guide. If the Department would wish to see assesseees in India come up to the level of assesseees in England in the matter of honesty and straight dealing, the Department and its officers must also in their turn adopt the helpful sympathetic and just attitude which appears to be such a striking feature of the Income-tax Administration in England.”*

Question No. 98.—What changes would you suggest in the existing arrangements relating to:

- (i) issue of notices;
- (ii) simplification and filing of returns;
- (iii) levy of penalties;
- (iv) recovery of tax; and
- (v) appellate procedure and machinery, particularly with reference to administrative control over Appellate Assistant Commissioners?

98. 1. *Penalties.*—Penalties should not be levied for technical offences, nor should they be imposed with a view to augmenting the revenue. If the deterrent object underlying a penalty is to be served, the punishment must vary with the nature and magnitude of the offence. The Department however tends to inflict severe penalties as a matter of course even when the defects on omissions are not *mala fide* and there is no intention or attempt on the part of the assessee to suppress or conceal the real income or cheat the revenue of its dues. Penalties imposed harshly or without occasion or justification exacerbate good relations and leave a trail of mutual antagonism. The current tendency is markedly in this direction and it should be curbed.

98. 2. *Recovery of Tax.*—Tax liabilities are frequently very heavy. This is particularly so when pending assessments are rapidly completed one after another. It is not suggested that payment of tax liability that is due should be indefinitely delayed. But when such demands are made all of a sudden and all together, the assessee finds it extremely difficult to pay them off at one stroke. All the money required is not held by him in cash and he has to make arrangements for securing the necessary liquid funds. That takes time. After all it is not the fault of the assessee that assessments are not completed regularly and the depressed conditions and the current stringency in the money market add to his difficulties. Therefore, the assessee should be granted reasonable time within which to pay the tax by suitable instalments as was the practice in the past. These facilities have been drastically curtailed exactly at a time when they are needed most. It is true that the Income-tax Officers have the power to distribute the payment of the tax liability over a period of time. Unfortunately, they decline to make even a conservative use of their discretionary authority and the assessee is not allowed a reasonable time within which he may have an opportunity of making arrangements for paying off his tax dues. It is clearly necessary that much more liberal consideration should be shown in this matter than is now accorded.

98. 3. *Delay in Disposal of Appeals.*—An assessee is generally helpless before the Income-tax Officer who assesses his liability to tax. The powers vested in the Income-tax Officer are so sweeping as to verge on the arbitrary and not unoften they are arbitrarily used. The remedy of the assessee lies in preferring an appeal. The appeal is an instrument for obtaining redress and it is but proper that the decision should be given at an early date. Whether an assessee files an appeal or not, the amount for which he is held liable in the first instance has to be promptly paid, and if the judgment is delayed, the hardship suffered by the assessee is obvious. Sometimes when the appeals remain pending for long, on occasions for as long as two or three years, the assessee is driven into a desperate position. He is subjected to further hardship because in the period that intervenes before the appeal is at long last decided the assessments for the years subsequent to the one in appeal are completed one after another on exactly the same grounds as the ones objected to in the assessment under appeal. In addition, advance payments of tax are

* Report of the Income-tax Investigation Commission, 1949, Part I, Para. 279.

** See Report of the Income-tax Investigation Commission, 1949, Part I, Sec. II, Para 19.

† Report of the Income-tax Investigation Commission, 1949, Part I, Para. 357.

‡ Report of the Income-tax Investigation Commission, Part I, Para. 445.

* Report of the Income-tax Investigation Commission 1949, Part I, Para. 281.

also determined on the same basis. In each case, the amount of income-tax demanded has to be paid straight-away and the assessee is at times faced with a crisis in his affairs. Often decisions in appeal reduce the assessed tax liability and a refund is allowed. But that is poor consolation to an assessee who may conceivably have to borrow money, sell his investments and mortgage his assets for payment of taxes that are not really due. Therefore, it is essential that a reasonable time limit should be prescribed for disposal of appeals. It should be further provided that where an appeal is entered only the agreed tax should be paid by the assessee, the balance amount being paid, with interest if necessary, as and when the appeal is decided against him.

98. 4. *Appellate Procedure.*—As pointed out above, the hearing of appeals is often long delayed and sometimes years pass before an appellate decision is reached. In the meanwhile, other assessments continue to take place. The point at issue in appeal may be peculiar to a particular assessee or a particular assessment; on the other hand, it may be of wider interest or common to a number of other assessments. In either case, there is hardship and inequity unless the appeals are expeditiously disposed of. Where, however, the question in appeal affects a trade as a whole or a large number of assessees, it is necessary to devise some machinery whereby the final decisions of the appellate authorities may be rapidly obtained. At present, in such cases, small assessees forfeit their rights as they have neither the inclination nor the means to go in appeal. The wealthier assessees also suffer and the appellate work is unnecessarily multiplied by reason of the same issues being agitated in a number of appeals. The resulting costs and harassment would be much reduced and the ends of justice would be met if in such cases some simple procedure were made effective for speeding up or over-riding the intermediate stages in order that the final verdict may not be unduly delayed.

98. 5. *Administrative Control over Appellate Assistant Commissioners.*—It is a well recognised principle that the executive and the judiciary should be, in so far as is possible, distinct and apart. However, Appellate Assistant Commissioners, who perform exclusively judicial functions, are at present under the control of the Central Board of Revenue which is the chief executive authority in matters of revenue and to whom the Appellate Assistant Commissioners must look for preferment and promotion in their official career. It is therefore a standing complaint that the Appellate Assistant Commissioners are unable to bring to bear an independent judgment in the appeals before them and that they are apt to be influenced more by revenue considerations than by the merits of the case argued before them. On this point, the Income-tax Investigation Commission observes that—

“On the principle that not only should justice be done but that it should appear to be done and should inspire confidence in the persons concerned, we think that the present system requires attention. We think that the present system begun in 1939 should be carried forward and Appellate Assistant Commissioners should be removed from the control of the Commissioners and the Central Board of Revenue and placed under the Appellate Tribunal.”*

This recommendation should be implemented and appointments of Appellate Assistant Commissioners should be made by the Ministry of Law on the advice of the President of the Appellate Tribunal. Such a change over will give a feeling of security to assessees and infuse greater confidence in the impartiality of the orders passed in appeal.

Question No. 99.—(a) Do you think that undue delay occurs at present in the course of assessment proceedings? If so, what do you attribute this to and what are your suggestions for remedying this?

(b) In order that delays of the kind mentioned above do not appreciably affect collection of a substantial portion of the tax due, should any special concessions be provided to assessees to induce them to make advance payment of tax?

99. 1. *Undue Delay in Assessment.*—It is a matter of common experience that undue delay occurs at present in taking up assessments and in completing them. The delay is conspicuous when assessments do not hold out possibilities of a substantial tax demand or when they are likely to end in refund of tax collected at source or paid in advance. To quote the Income-tax Investigation Commission again, this is because the Income-tax Officer—

“is judged efficient not by the knowledge he shows or the manner in which he deals with the assessees, but the increase he makes in the demand of tax.”**

* Report of the Income-tax Investigation Commission, 1949, Part I, Para. 319.

** Report of the Income-tax Investigation Commission, 1949, Part I, Para. 445.

When the Income-tax Officer feels about an assessment that little can be demanded by way of tax or that refund will have to be granted, he postpones consideration, hoping that a transfer early or late will enable him to pass on the unprofitable task to his successor in office. The transfer of Income-tax Officers at short notice when they are in the middle of part-heard assessments also contributes to delay as the procedure has to be gone through *de novo* before the new incumbent. It would be of some advantage if the Income-tax Officers were transferred after adequate notice and required to complete the pending assessments as far as possible before handing over charge to their successors. This would obviate to some extent the duplication and waste inherent in the present procedure. However, the most potent cause of delay lies in the system of advance payment of tax under Section 18-A. Once the tax is collected in advance and credited to the revenue, the incentive to take up assessments for consideration and complete them with speed and dispatch is greatly weakened. The assessee is left dangling at the end of the rope and his difficulties and anxieties are a matter of little consequence to the Department which sits tight on what it has. The situation can be set right only if the present system of payment of tax in advance is abolished. Instead, as suggested in the answer to Question No. 75 above, it would be feasible and desirable to adopt the simpler system of requiring an assessee to pay tax within three months of the submission of his return on the basis of the income computed by him as having accrued. This will relieve the tax-payer of his liability to pay taxes not ultimately due and of waiting endlessly for the refunds. At the same time, it will secure payment of the tax before the assessment is completed and compel the Department to proceed with the assessments without the present vexatious delays.

Question No. 100.—What, in your opinion, would be the circumstances which would justify the levy of Excess Profits Tax or special business taxes?

100. 1. *Excess Profits Tax Appropriate to War Conditions: Only.*—The Excess Profits Tax is an abnormal tax and can only be imposed in abnormal war times when extraordinary circumstances come into existence. In such a great national emergency as that of war, normal civilian production and consumption are drastically curtailed, essential resources are commandeered by the State and the productive machinery and economic system are geared to the task of supplying the needs of the country arising out of war conditions. At such times, the import and export trade is disrupted, normal channels of supply are frequently cut off, artificial scarcities arise and artificial war-time demand is created. While some businesses become difficult to carry on and some have to be closed down, others yield fabulous profits from war orders. These abnormally large profits accruing in such extraordinary circumstances are in the nature of windfall gains. On the other hand, the State also becomes the largest single spending agent. It incurs vast expenditure on defence and war services and supplies, and unless that huge outlay is mopped up by savings or taxation, there is the ever present danger of a runaway inflation in the context of the prevailing scarcities. An Excess Profits Tax then gains ground both in equity and economic necessity. On the simple principle that no one can exploit the needs of a community when its existence is at a stake and make a profit out of it, equity justifies a tax on the windfall gains in the form of an Excess Profits Tax. At the same time, such a tax produces a substantial amount of revenue to cover the cost of the defence effort and acts as a damper on inflation. It is for these reasons that the Excess Profits Tax is employed as a recognised method of taxation in times of war.

100. 2. *Excess Profits Tax Not a Peace-Time Tax.*—The Excess Profits Tax ceases to have any reasonable justification when the abnormal conditions of war give way to a peace-time economy. If retained thereafter, it becomes progressively more and more inequitable and burdensome. Arbitrary attempts at differentiating between legitimate high earnings from services rendered on the one hand and so-called excess profits on the other hamper expansion of business activity and development of new productive capacity. Base earnings defined either as average earnings of some specified pre-war period or representing a specified rate of return on invested capital lead to hardship as conditions continue to change from year to year till finally they bear little relation to the base or so-called normal period. Further, as the extraordinary effects of war on the economy wear out and the abnormal conditions return to normal, the element of windfall profits also ceases to exist. As such, the Excess Profits Tax does not tax excess profits but normal profits. In the one case, the tax is levied on some historical base which perpetuates every inequality existing in the base period and takes no account of subsequent changes. In the other case, the tax assumes an arbitrary fair return when in the nature of things such return varies from industry to industry and unit to unit depending on the degree of stability of earnings and the risks of capital appreciation or depreciation

affected by such technical factors as the original cost of assets, write-ups and write-downs, depreciation and other reserves, valuation of goodwill, trade-names and other intangibles, recapitalizations, mergers, reorganizations, etc. The straitjacket of a base period or a single measure of fair return damages initiative, efficiency and enterprise. It particularly hits newly formed, ambitious and rapidly growing companies which push ahead most aggressively in developing new products and processes and are willing to risk capital in return for large earnings. It also leads to stagnation and encourages waste and extravagance because it singles out for heaviest burdens those very concerns which are the most efficient in holding down costs. When increments in profits above a certain level are taken away, there is a laxity in such matters as salary and wage increases, bonuses, surplus staff, costly repairs and other wasteful expenses in as much as it is the Government which foots the bill. These stimulate the inflationary forces which the tax is intended to suppress and the incentive for economy, efficiency and progress is seriously weakened. In these circumstances, sooner or later, and sooner rather than later, the Excess Profits Tax has to be abandoned.

100. 3. *Special Business Taxes.*—Most of the reasons set out in para. 100.2 above, which make an Excess Profits Tax harmful and inequitable in peace-time conditions, apply with equal force to special business taxes in any other form. Income-tax, super-tax and corporation tax already impose a heavy penalty on business enterprise. To add to them a special business tax would be to drain off most of the operating earnings and leave little to plough back into business or to form the new capital needed for growth and development. The levy of such a tax would also be highly inequitable and work unfairly on a very large proportion of the investing public, particularly the middle-class shareholders who have a stake in joint stock enterprise. Each individual must be taxed according to his income which broadly indicates his ability to pay. To single out the business group out of the whole community and to subject it to any special business tax, especially in a country like India where agricultural income is almost exempt from income-tax, would be to indulge in grossly unfair discrimination from any point of view. In practice also, it would be far from advisable to burden the economy with such special imposts. They would soon push taxation beyond the point of tolerance when every addition would put a large premium on inefficiency and stagnation and react more and more adversely in terms of enterprise, development, expansion and productivity, much to the detriment of the country as a whole. It follows that there are no grounds for imposing special business taxes.

SPECIAL NOTE.

Re. Exemption from Tax of Trade and Professional Associations and Other Non-profit Making Organisations.—It may be pointed out that in the U.S.A. chambers of commerce, trade associations and other non-profit making organisations are exempt from tax. The test to be applied to such cases is that no benefit should enure to any private shareholder or individual. In India, the assessment of trade and professional associations is on a special footing and is governed by Section 10(6) of the Income-tax Act. Discussing the position arising therefrom, the Income-tax Investigation Commission observes as under:

"Sub-section (6) of section 10 of the Income-tax Act was inserted in 1939 on the recommendation of the Ayers Committee. Objection has been taken in one or two of the replies that in applying this provision, items of necessary expenditure are not allowed to be deducted. We understand that the practice is to allow expenditure to be deducted in the proportion which the taxable portion of the Association's income bears to the non-taxable portion. If, in any case, this is not being done, the matter may be looked into. If, however, the claim is that the whole expenditure should be allowed as a deduction from the taxable income irrespective of a part of the income being non-taxable, we believe that it will be difficult to reconcile the admission of such a claim with the general scheme of the Act. Reliance has been placed on the analogy of the provision permitting co-operative societies to set off a deficit resulting from non-taxable activities against income subject to taxation. Such a provision cannot be made applicable to all mutual associations. It will be for the Government to consider whether there is reason for extending the principle to any particular categories of mutual associations and if any such are found, special provision may be made for them."

In spite of what the Commission has been given to understand, it is the experience of the Stock Exchange as an association that admissible expenses are arbitrarily disallowed and as a result heavy tax liabilities are imposed on a semi-public non-profit making institution

* Report of the Income-tax Investigation Commission, Part I, Para. 102.

which have the effect of denuding its reserves and crippling its financial stability. The question, being *sub judice* at present in so far as the Exchange is concerned, cannot be pursued here in any detail. However, as stated by the Income-tax Investigation Commission, the desirability of making a special provision for certain associations requires careful consideration and it is submitted that where an association is an association of individuals not formed with the object of making profits and/or distributing profits but with the object of regulating a trade or profession or for any other public purpose it should be completely exempt from tax.

PART V—OTHER TAXES (Central and State).

Question 162.—Under the Constitution.—

- (1) *the Union is empowered to fix the rates of stamp duties in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts, and*
- (2) *the States are empowered to fix the rates of all other stamp duties.*

As regards both (1) and (2), have you any suggestions to make for the levy of a stamp duty where it is not already levied, or for an increase or decrease of the present rates where a stamp duty already exists? Please give reasons for your suggestions. Are there any general principles which you would propose for adoption in regard to the fixation of rates of stamp duties?

As regards (2), since the rates vary from State to State, what degree of uniformity do you consider desirable and feasible, and how do you propose to achieve it?

If possible, please estimate the net effect of your proposals on the revenues of States.

162. 1. *Nature of Stamp Duties.*—Stamp duties are sometimes regarded as fees for services but the general view which treats them as taxes seems to be more correct. These taxes suffer from serious defects. It is not possible to say in any particular case whether they have been rightly imposed. They cannot be graduated to conform to the capacity of the tax-payer, nor can their rates be determined on any principle other than that of not pitching them up beyond the point of diminishing returns. The Indian Taxation Enquiry Committee (1924-25) admits that—

"The system of levying duties on documents relating to transfers of property and commercial and other transactions is theoretically not one of the best methods of taxation, and has been criticised by many economists as unsound and subserving no principle.....Taxes on commercial instruments are, so far as they go, a check on development..... Hobson in his 'Taxation in the New State' regards stamp duties generally as a restraint on trade or other forms of presumable personal and social utility."

In fact, Hobson goes much further and condemns stamp duties in the following unequivocal terms:—

"They are cumbersome relics of the past, haphazard methods of catchponny improvisation, which have no place in a scientific system of finance."

This notwithstanding, stamp duties continue to survive in most modern tax structures as they constitute a lucrative source of revenue.

162. 2. *Principal Guides.*—Stamp duties have secured a place for themselves in the tax system of the country, and as they more or less collect themselves, they are not likely to be dispensed with from the point of view of practical administration. The Indian Taxation Enquiry Committee (1924-25) therefore suggests the following principal guides to rates of stamp duties:—

- "(1) The point at which the value of the convenience or utility attaching to the use of a particular kind of transaction approaches the amount of stamp duty involved.
- (2) The point of diminishing returns, or, in other words, what the traffic will bear.
- (3) The point at which hardship on any class of the community is involved."

162. 3. *Limitation and Adverse Experience.*—In practice, the principal guides suggested by the Indian Taxation Enquiry Committee have been set at naught when fixing the rates of stamp duties. The U. N. Public Finance Survey of India observes:—

"The rates of these (stamp) duties have been substantially raised from time to time and over 50 per cent. more additional revenue is now collected from

* Report of the Indian Taxation Enquiry Committee, 1924-25, Ch. X, Para. 278.

** Report of the Indian Taxation Enquiry Committee, 1924-25, Ch. X, Para. 282.

the States of the Indian Union than was available from undivided India in 1938. There is a strict limit, however, to the amount of additional revenue which can be raised from this source without interfering with business habits.**

This is confirmed by Table No. 162.I which records the stamp duty revenue of Part A States from 1938-39. The Table also gives separately the amount collected under the heads judicial and non-judicial stamp duties in the Bombay State from which it is clear that the revenue from non-judicial stamp duties is now almost four times that of 1938-39. In fact, in regard to some duties, the point of tolerance appears to have long since passed. The stamp duty on transfer of shares, as shown in the following paragraphs, has imposed a heavy burden. The incidence of the stamp duty on contracts relating to purchase and sale of stocks and shares has been even more penal and destructive in its repercussions. The injury it has worked has been referred to in answer to Question No. 17 in Part I of the Questionnaire and the subject is dealt with in greater detail in the answer to Question No. 163 below. In inflicting these duties, the State Government seems to have been oblivious of the fact that there are certain over-riding limits which it is imprudent to ignore. The Indian Taxation Enquiry Committee (1924-25) warns:—

“An excessive enhancement of the rates may impede transfers of property and cause a diminution of business generally, or it may lead to an evasion of the duties or a neglect of the requisite formalities of stamping.....Excessive stamp duties not only retard business, but defeat their object by tempting persons who have to pay them to resort to evasion, both legal and illegal.**

** Report of the Indian Taxation Enquiry Committee, 1924-25, Ch. X, Para. 281.

* U. N. Public Finance Surveys—India, 1951, Ch. IV, p. 48.

The fears expressed by the Committee have been unfortunately realised. Business has tended to dwindle under the back-breaking load of stamp duties and the tax-payer has been weighed down by the cumulative burden almost beyond the point of endurance.

162. 4. *Share Transfer Stamp Duty.*—Before 1921, the stamp duty rates were fixed by the Centre under Schedule I to the Indian Stamp Act, 1899. The share transfer stamp duty was high enough then, the rate having been raised by Act VI of 1910. Subsequent to devolution, provincial legislatures were empowered to introduce legislation for enhancement of stamp duties. As a result, from time to time either the duties were increased or surcharges were imposed indiscriminately by various States. These tendencies were discernible even in 1924-25 when the Indian Taxation Enquiry Committee reported as under:—

“The Governor General reserved certain items for central legislation and allowed a free hand to the local legislatures to deal with the rest. Thereupon, several provincial legislatures increased the duty on all, or almost all, the items of the schedule which had not been reserved for central legislation, and in most cases the increases took the shape of a percentage increase of the existing rates without any detailed consideration of the burden they imposed upon particular classes of transactions.”*

These tendencies continued to operate in more than one State long after the Committee reported. For example, in Madras the share transfer stamp duty was doubled, in U.P. a surcharge of 25 per cent. was levied and later consolidated in the basic duty and in Bombay a 50 per cent. surcharge was imposed which still continues in force unabated. As a result of these patch-

* Report of the Indian Taxation Enquiry Committee, 1924-25, Ch. X, Para. 313.

TABLE No. 162. I.

(Crores of Rs.)

Year	Stamp Duty Revenue			
	Total for Part A States	Bombay State		
		Judicial	Non-Judicial	Total
1938-39	9.59	.67	.77	1.44
1939-40	9.78	.60	.79	1.39
1940-41	9.94	.63	.84	1.47
1941-42	10.32	.58	1.04	1.62
1942-43	10.75	.57	1.13	1.70
1943-44	14.64	.66	1.79	2.45
1944-45	15.62	.66	2.07	2.73
1945-46	17.00	.69	1.98	2.67
1946-47	18.78	.77	2.54	3.31
1947-48	13.84	.84	2.62	3.46
1948-49	16.31	.86	2.57	3.43
1949-50	17.32	1.04	2.54	3.58
1950-51	19.22	1.23	2.87	4.10
1951-52	18.83	1.25	2.89	4.14
1952-53 g	18.96	1.39	2.73	4.12
1953-54	19.84	1.27	2.93	4.20

(Source: Reserve Bank of India Reports on Currency and Finance and Bombay State Budgets.)

work developments, the rates of stamp duty on transfer of shares are no longer uniform throughout the country as at one time they used to be. Table No. 162. II shows how the rates differ in different States. The Table also reveals the wide range of variation, the maximum rate being 300 per cent. as high as the minimum. The heavy burden they impose is apparent from Table No. 162. III which sets out the revenue derived from share transfer stamp duty in Bombay State alone. It seems clear that the rates are exorbitant and that they tend to impede the free circulation of shares and the free flow of investment capital that are so desirable in the public interest. The high scale adversely affects the yield on shares proposed to be held for a short duration and is a hindrance in the way of investors who find these charges irksome and top-heavy. For these reasons, it

TABLE No. 162. II.

State	Stamp Duty Per Cent. on Transfer of Shares
Rs. A. P.	
Madras	1 8 0
Bombay	1 2 0
Bihar	1 1 0
U. P.	0 15 0
West Bengal	0 12 0
Mysore	0 10 0
Hyderabad	0 8 0
Travancore-Cochin	0 8 0

has been consistently urged for a long time not only by the Stock Exchanges but also by all trade associations and chambers of commerce as well as by the general public that the surcharges on share transfer stamp duty should be abolished wherever they exist and that the duty itself should be substantially reduced. It would be therefore appropriate if a moderate rate of stamp duty, say, at 1/4 per cent. of the consideration amount were made uniformly applicable throughout the country, the unit being fixed in terms of Rs. 100 of the consideration amount to ensure an even spread of the incidence of the tax.

TABLE NO. 162. III

(In Lakhs of Rs.)

Year	Bombay State Stamp Revenue	
	Total Non-Judicial	Share Transfer Stamp Duty
1938-39	77-26	9-69
1939-40	78-82	10-50
1940-41	83-89	11-95
1941-42	103-89	17-17
1942-43	113-15	17-76
1943-44	179-28	32-76
1944-45	206-62	32-71
1945-46	197-67	33-84
1946-47	253-84	53-62
1947-48	261-44	32-01
1948-49	257-38	31-48
1949-50	253-83	20-10
1950-51	287-29	22-63
1951-52	288-65	25-17
1952-53	272-78	19-00
1953-54	293-41	23-94

(Source: Bombay State Budgets.)

162. 5. *Misapprehensions about the Blank Transfer System.*—Not infrequently it is alleged that a large amount of revenue is being lost because of the prevalence of the system of blank transfers. It is however not generally realised that, even when blank transfers are done away with, exemption from full stamp duty has to be allowed in several cases as, for example, when the transfer vests the property in trustees on the appointment or retirement of a trustee, or when the transfer is to a mere nominee of the transferor when no beneficial interest in the property passes, or when the transfer is by way of security for a loan or a retransfer to the original transferor on repayment of loan, etc. If such exemptions which in any case have to be allowed are kept in view, the complaint that there is an enormous leakage of revenue loses its main force. In fact, the complaint is largely misconceived and rests on the unverified assumption that shares bought from the market are held on blank indefinitely. So far as shares officially quoted on the Bombay Exchange are concerned, the Exchange is in a position to prove that most of the shares delivered through the market do not continue to circulate on blank indefinitely but are in actual fact lodged with companies for registration. This is not only in conformity with the trends appearing in Table No. 162. III but also squares with the general experience that banks normally do not advance money on pledge of shares unless the shares are registered in their name or in the name of the borrower and that there is a rush for registration of shares particularly at dividend time as the system of companies paying dividend on mandate has fallen into disuse and dividends are only paid to registered shareholders. Facts must take precedence over misapprehensions, no matter how frequently repeated. It is significant to note that apart from the U. K. (where, among other things, the London Stock Exchange has a unique differentiation between brokers and jobbers and where there are such facilities for rapid registration of shares by companies and specialised registering corporations that share certificates are returned duly endorsed within two or three days of the date of lodgment in contrast to two or three months taken in this country), the system of blank transfers or bearer

shares is regarded as indispensable in almost all other parts of the world including the U. S. A. and the continent of Europe. Apart from the revenue aspect, it seems apposite to discuss here in detail the merits of the blank transfer system. The subject has been fully canvassed on other occasions and the views of the Exchange have been expressed in its "Comments on the Draft Securities Contracts (Regulation) Bill, 1951," the relevant portion of which is annexed as an appendix at the end of the reply to this Question. It is enough to state that the system is an integral part of the stock exchange mechanism and that it intimately concerns banks and the money market in general and enters into the daily business life of the country as a whole. In this connection it is pertinent to refer to a Circular bearing No. 8 (XXX-3) issued by the Central Board of Revenue on the 10th of April, 1953, which withdrew, or appeared to withdraw, the tax credit concessions available before that date in respect of shares held on blank transfer, such withdrawal being, from the legal point of view, in full conformity with the Bombay High Court Judgment in *Shri Shakti Mills, Ltd., vs. Commissioner of Income-tax* (1948 I.T.R. 187). The Circular caused considerable apprehension in all quarters and representations were made not only by the Stock Exchanges but also by the Indian Banks' Association, the Federation of Indian Chambers of Commerce and Industry and numerous other bodies representing the banking and commercial interests all over the country. As a result, a fresh Circular bearing No. 31 (XXI-4) was issued by the Central Board of Revenue on the 1st of December, 1953, "with a view to removing misapprehensions on the subject" contained in "representations from several quarters" and the status quo was practically restored by allowing tax credit as before in respect of shares held on blank. It follows that the importance of the system cannot be seriously disputed. And the conclusion is that, whether the considerations relate to revenue or otherwise, instead of appealing to a fixed idea or relying on preconceived notions, the facts of the situations must be accepted as they are and not as they are imagined to be.

162. 6. *Other Misapprehensions.*—Some other misapprehensions entertained about stamp duties are, for example, that large revenue is lost—(a) through avoidance of probate and letters of administration; and (b) through wrongful use of used transfer stamps. Here also, it is necessary not to lose sight of the facts or the correct perspective.

(a) The first complaint seems to be that Companies frequently transfer shares out of the names of deceased holders without insisting on probate or letters of administration. The general experience, however, is that Companies are not prepared to waive production of probate or letters of administration except when the shareholding is very small. Even in such cases, it is a question how far the facility is availed of because it is difficult for small investors to arrange for the kind of indemnity which Companies usually require. As pointed out before, it is a serious defect of stamp duties as a mode of taxation that they cannot differentiate between tax-payers as to their capacity to pay. If the small investor is to be encouraged to invest his savings in shares of joint stock companies, instead of penalising him by making production of probate or letters of administration compulsory, it is necessary to devise some means whereby the existing procedure can be simplified and made less expensive and more easily available to the small and middle-class investors.

(b) The second complaint is that the use of adhesive label, which is generally found to be so great a convenience as to make it indispensable, results in loss of revenue because stamps even when cancelled with indelible ink are used more than once as they can be easily removed. There seems to be no basis for entertaining such fears, at least so far as Bombay State is concerned. Rule 16 of the Bombay Stamp Rules, 1939, provides as under:—

"Share Transfer stamps affixed to deeds of transfer of shares, shall, before effect is given to the transfer by the Joint Stock Company concerned, be cancelled by the Company by means of a punch which can perforate either the word "Cancelled" or an abbreviation thereof, namely, "Cancelld." or the initials of the Company, even when the stamps were previously cancelled in accordance with Section 12 of the Indian Stamp Act. In case a company fails so to cancel the share transfer stamps as provided by this rule the company shall be liable to the penalty prescribed by section 63 of the Indian Stamp Act."

Stamps, once punched as required by the Rule quoted above, are incapable of being used again. Accordingly, the system may with advantage be extended to other States wherever it is not in vogue, irrespective of whether there is fraud or not, though the complaint itself, is, it is believed, mistakenly conceived as it relates to the period before the amendment to Rule No. 16 cited above was passed.

162. 7. *Transfer Stamp Duty on Debentures*.—As in the case of shares, so in the case of debentures, or perhaps even much more so, the transfer stamp duty is a source of great hardship. Under Section 15 of the Foreign Exchange Regulation Act, 1947, there is for all practical purposes a ban on the issue of bearer debentures. On the other hand, the transfer of registered debentures attracts full stamp duty which in the Bombay State is on the high scale appearing in Table No. 162. IV below. The debenture market, like the gilt-edged market, is governed primarily by considerations of yield or net return on the moneys invested. In such cases, even a fractional change makes a material difference. However, the incidence of the stamp duty is extremely heavy in relation to the yield factor, so much so that switch over of investments in debentures has become altogether unprofitable and business in the debenture market has been driven almost to a standstill. It is most necessary that the transfer stamp duty on debentures should be made nominal, if not completely abolished, so that the debenture market may revive and investment in this form of security which is dependent on fine differences in yield may not be unfairly handicapped.

TABLE NO. 162. IV.

Consideration Amount	Scale of Stamp Duty on Debentures		
	Rs.	A.	P.
Does not exceed—			
Rs. 10	0	3	0
Rs. 10—50	0	6	0
Rs. 50—100	0	12	0
Rs. 100—200	1	8	0
Rs. 200—300	3	6	0
Rs. 300—400	4	8	0
Rs. 400—500	5	10	0
Rs. 500—600	6	12	0
Rs. 600—700	7	14	0
Rs. 700—800	9	0	0
Rs. 800—900	10	2	0
Rs. 900—1,000	11	4	0
and for every Rs. 500 or part thereof in excess of Rs. 1,000.	5	10	0

162. 8. *Uniformity in Stamp Duties Essential*.—Item No. 91 of the Union List appearing in the Seventh Schedule to the Constitution provides that, among others the rates of stamp duty on transfer of shares and debentures should be fixed by the Centre. The provision is clearly intended to ensure uniformity in the rates levied in different parts of the country. The practical consideration that it is undesirable to have varying rates of stamp duty has been emphasised by the Indian Taxation Enquiry Committee (1924-25) when it says that—

“The existence of different rates in different Provinces causes inconvenience.”*

Apart from the trouble involved in arranging for payment of excess duty, the current diversity creates difficult questions in respect of the validity and acceptance of documents in States where a higher stamp duty is in force than where the documents have been executed. It is necessary to bring about uniformity in the levy of stamp duties not only in regard to documents enumerated in Item 91 of the Union List but also in regard to documents covered by Item 63 of the States List appearing in the Seventh Schedule to the Consti-

* Report of the Indian Taxation Enquiry Committee, 1924-25, Ch. X, para. 314.

tution. As pointed out in the answer to Question No. 163 dealing with stamp duties on contracts relating to purchase and sale of stocks and shares, the unrestrained and almost predatory demands of the State Government have tended either to disrupt or divert the business of the Bombay Exchange which, the State Government needs to be reminded, is a national market in stocks and shares in which people all over the country, and not in Bombay alone, have a vital interest. The present rate structure is penal in its operation and complications are arising which must be avoided. These were foreseen by the Indian Taxation Enquiry Committee (1924-25), which sounds this note of caution:

“Thus, while the enactment of central legislation governing the duties leviable upon a considerable category of important documents in itself forms a tacit admission of the desirability of uniformity, the actual experience of the five years of working in the provinces since the introduction of the Reforms tends to emphasise this necessity. It is abundantly evident, from the point of view of the administration of the stamp law, that all the advantage lies in favour of uniform legislation and unified rates.”*

Though the rates of stamp duty on documents other than those specified in Item 91 of the Union List are outside the purview of the Central Government, there is no manner of doubt that the freedom now available to the States in this respect must be fettered for the public good, and that, as recommended by the Indian Taxation Enquiry Committee, provision must be made for Central legislation and Central control resulting in a uniform law and unified rates for all documents in the interests of what has been called “the harmonization of taxation”.

ANNEXURE.

(Referred to in para. 162. 5 above.)

Extract from the Stock Exchange “Comments on the Draft Securities Contracts (Regulation) Bill, 1951.”

“The argument in favour of abolition or limitation of blank transfers is befogged by opinions and fuddled by sentimental references to anti-social activities. Instead, the Exchange would appeal to facts as they are.

I. The first and principal argument for abolition or limitation of blank transfers is that the black-marketeer, income-tax dodger and clandestine manoeuvrer buys shares and keeps them on blank thus concealing his ownership from Government and the income-tax authorities and wresting away control of companies without the cognizance of directors.†

The Exchange flatly repudiates the argument which rests on the unverified assumption that shares are bought from the market by the black-marketeer, tax-dodger, and clandestine manoeuvrer and held on blank indefinitely. The Exchange goes one step further and invites a factual investigation. So far as shares officially quoted on the Bombay Exchange are concerned, the Exchange is prepared to prove that most of the shares delivered through the market do not continue to circulate on blank indefinitely but are in actual fact lodged with Companies for registration. Facts take precedence over argument and must prevail. Assuming however that the facts are otherwise and that shares instead of being lodged for transfer continue to be held on blank indefinitely, even then there appears to be no ground for abolishing or limiting blank transfers because of the following reasons:—

(a) Shares on blank offer no greater facility to the black-marketeer or tax-dodger than investment, for example, in Government Securities, bullion, precious stones, etc. If there is abuse, leaving out of account the other numerous ways and means, the scope is much larger in the case of Government Securities alone, as such securities are transferable by mere endorsement and delivery and their total outstandings amount to about Rs. 1,500 crores which exceeds three times the market value of quoted shares computed at about Rs. 450 crores.

* Report of the Indian Taxation Enquiry Committee, 1924-25, Ch. X, para. 316.

† Without entering into merits or demerits, it is noted with interest that, out of the eleven members of the Stock Exchange Legislation Committee, three members—Mr. A. D. Gorwala, Mr. P. S. Nadkarni, and Mr. G. P. Kapadia—have advocated this argument, one members—Mr. A. D. Gorwala, Mr. P. S. Nadkarni, and the remaining seven members—Mr. K. R. P. Shroff, Mr. B. N. Chaturvedi, Mr. Pranlal Devkar Nanjee, Mr. P. D. Himtasingkha, Mr. V. S. Krishnaswamy, Mr. Jagomohandas J. Kapadia, and Mr. L. S. Vandyathanan—have expressed themselves against this argument.

(b) Compulsory registration of shares will not enable Government or the income-tax authorities to locate the actual holding of a black-marketeer or tax-dodger who is prepared to practise fraud as it is not feasible to examine all share registers and find out which shareholders are honest and *bona fide* tax-payers and which of them are black-marketeers and tax-dodgers.

(c) Even if registration scares away the black-marketeer or tax-dodger from holding shares, that will not stop him from his anti-social activities of black-marketing or tax-evading as such. He will only divert his ill-gotten wealth to other channels where it would either perform no economic function or else further some other anti-social activities. When shares are held on blank by the black-marketeer or tax-dodger, he at least pays tax at the maximum rate on the dividend income as companies deduct income-tax at source, whereas even that tax will not be realised if the black-market and tax-evaded monies are employed in other directions.

(d) Compulsory registration will not prevent the monopolistic black-marketeer or tax-dodger from purchasing shares. If the black-marketeer or tax-dodger succeeds in so purchasing a majority holding, the control of the Company vests in him irrespective of whether the shares are held on blank or lodged for transfer or whether registration is refused or accepted because the moment the registered shareholder sells the shares he becomes a trustee and has no choice except to act in whatever manner the black-marketeer or tax-dodger, as the beneficial holder, directs. It is not the system of blank transfers but the concentration of wealth in the hands of the black-marketeer or tax-dodger which enables him to grab control and the evil can only be curbed by a blanket law prohibiting all change in the controlling management of a Company except with the sanction of Government. That has now been done by the Indian Companies (Amendment) Act, 1951.

(e) Lastly, compulsory registration will not make share registers more complete than what they are today. So long as floating stock exists—and it must exist if Stock Exchanges are to function—and so long as holdings by banks in different accounts and nominee holdings continue, the membership registers of Companies will remain incomplete no matter what is done and whether blank transfers are abolished, limited or not.

II. The second principal argument for abolition or limitation of blank transfers is that blank transfers stimulate unhealthy speculation. How that happens has been nowhere explained. Apparently, the only point put forward in support of the view is that blank transfers circulate and accumulate with the result that the floating stock weights on the market and exercises an unhealthy influence.

This argument involves an obvious fallacy. Floating stock does not change its character and cease to be floating stock only because the intermediate holder financing the stock is compelled to lodge the shares for registration. Abolition or limitation of blank transfers does not either increase or diminish the size of the floating stock. It follows that though at times the floating stock may act as a drag on the market, the abolition or limitation of blank transfers cannot remedy the position as it cannot reduce the weight of the floating stock.

Far from checking unhealthy speculation, the abolition or limitation of blank transfers will seriously impede the smooth functioning of the Stock Exchanges and directly lead to the following undesirable consequences:—

(a) Blank transfers provide the stock-in-trade which keeps the market supplied with shares whenever required. Compulsory registration will mean that the stock lodged with the companies will not be available for delivery. There will be a recurring artificial scarcity of floating stock with the result that, as is now the case with the Bullion Association, periodic squeezes and emergencies will overtake the Stock Exchanges necessitating undesirable outside interference. Thus long-term speculation which is *bona fide* speculation giving direction and stability to the market will be severely penalised.

(b) On the other hand, undesirable short-term speculation based on a rapid turnover for differences will be directly stimulated. Instead

of taking delivery and undergoing the delay and the expenses on stamp duty and transfer charges involved in compulsory registration, it will be more profitable to close-out business at the end of each settlement. As a result there will be artificial pressure of sales at periodic intervals and price fluctuations will be accentuated.

(c) Lastly, the abolition or limitation of blank transfers by causing artificial scarcity of stock available for carry-over will give big financiers a strangle-hold on such business. Monopoly practices will be encouraged and the problem of control will be made more complicated.

III. The third and last main argument for abolition or limitation of blank transfers is that the precedent set by the London Stock Exchange on which delivery of blank transfers is discouraged should be followed in this country.

On this point it is apposite to quote Mr. E. H. H. Simmons, ex-President of the New York Stock Exchange. He says:

“My whole experience has taught me that every Stock Exchange must make its rules to fit its own particular environments, and to attempt to compare the methods of one market with those prevailing in another is always easier to do in theory than in practice.”

It is well known that the London Stock Exchange, the City of London, their business methods and practices and their traditions have no parallel in other parts of the world. The peculiar conditions obtaining in London which make it more advantageous to register shares than to hold them on blank are—

- (a) the unique differentiation between brokers and jobbers on the London Stock Exchange;
- (b) the special privileges accorded to jobbers and the concessions enjoyed by them in the matter of stamp duties; and
- (c) the facilities of rapid registration of shares by companies and specialised registering corporations situated within the few square miles of the City of London.

These conditions are non-existent in India or in other parts of the world where the system of blank transfers has had to be highly developed. For instance, in India there is no segregation between brokers and jobbers, the stamp duties are extortionate without suitable exemptions, and the distances and delays involved in registration of shares are notorious. It follows that, contrary to London, in India as in the U. S. A. and on the continent of Europe the blank transfer system occupies an important place and is considered to be not only desirable but indispensable as well.

IV. The foregoing examination of the principal arguments for abolition or limitation of blank transfers has elucidated some important points relating to the system. The following further points which establish its position and usefulness may also be briefly noted:—

- (a) Blank transfers have not been abolished by law in any important country. The system flourishes in all parts of the world. In the U. S. A. it has attained a high degree of perfection and on the continent of Europe bearer securities predominate.
- (b) In India also the system of blank transfers has existed since the birth of joint stock enterprise.
- (c) In his Report on the Regulation of the Stock Market in India, submitted to Government in 1947, Dr. P. J. Thomas has pointed out that without the use of blank transfers and bearer securities joint stock enterprise in the U.S.A. and on the continent of Europe would not have expanded to its present position. This is no less true of joint stock company development in this country.
- (d) Blank shares bear the same relation to joint stock enterprise which Promissory Notes do to Government securities. In fact, Promissory Notes being transferable by mere endorsement and delivery are more perfect instruments than shares on blank transfers. Since Promissory Notes are acknowledged to be necessary for Government borrowing, blank transfers are no less necessary for financing industry and providing credit for the trade and commerce of the country.
- (e) Registration of Government securities even without payment of stamp duty is not con-

sidered to be desirable on the ground that it would destroy their free negotiability. It follows that the abolition or limitation of blank transfers would no less impair the liquidity and marketability of shares.

(f) As a matter of observation, the Thomas Report has recorded that the blank transfer system "imparts a high degree of negotiability to securities along with safety for dealings". In fact these are the two prime requisites for the effective finance of joint stock enterprise. As a result the blank transfer system has become an integral part of the stock exchange mechanism.

(g) Finally, as blank transfers constitute an important instrument of day-to-day lending and borrowing, they intimately concern banks and the money market in general and enter into the daily business life of the country as a whole.

V. Summing up the position, it is apparent that the proposal for abolition or limitation of blank transfers has no validity in argument or justification in actual fact. On the contrary, it is clear that potentially the proposal is likely to do more harm than do any good."

Question 163.—*Certain States (e.g., Bombay) levy stamp duties on transactions in forward markets. What is your view regarding the complaint that these duties have tended to affect the business in these markets, particularly that of the middle class traders? If you consider that the levy of stamp duty*

on transactions in these markets is a suitable and potentially important means of securing revenue, what administrative and other measures would you suggest for the efficient collection of such duties? Alternatively, in place of stamp duties, would you suggest some other form of taxation of transactions in stock exchanges and futures markets? If so, please elaborate your suggestion.

163. 1. *Stamp Duty on Contracts of Purchase and Sale of Shares.*—A reference has been made in the answer to Question 17 of Part I of the Questionnaire to the punitive nature of the stamp duty levied on contracts relating to purchase and sale of shares and to its harsh repercussions on the members of the Stock Exchange. The character of the tax and its incidence call for an analysis in some detail.

163. 2. *Repeated Increases in Stamp Duty Rates.*—Articles 5(b) and 43(b) of Schedule I to the Indian Stamp Act, 1899, make it obligatory to stamp contracts relating to purchase or sale of shares entered into either—

(a) as principal to principal; or

(b) as agent to principal.

At first, the rates prescribed under these Articles were moderate and reasonable. However, after devolution, they were put up progressively step by step till they have reached the present oppressive proportions. Table No. 163. I traces the development and reveals at a glance how the stamp duty has grown and multiplied itself nine to twelve times over in the brief period of three decades. The tyranny of these repeated increases requires no elaborate comment.

TABLE NO. 163. I.

Period	Bombay State Stamp Duty on Contracts of Purchase or Sale of Shares					
	Unit		Rate per Unit			On a common unit of Rs. 20,000
	Rs.	Rs.	A.	P.		Rs. A. P.
Before 1-4-1922	10,000	0	1	0	Subject to a maximum of Rs. 10	0 2 0
From 1-4-1922 to 31-3-1932	10,000	0	2	0	Subject to a maximum of Rs. 20	0 4 0
From 1-4-1932 to 31-3-1938	5,000	0	2	0		0 8 0
From 1-4-1938 to 31-12-1943	2,500	0	2	0		1 0 0
From 1-1-1944 to 31-3-1950	2,500	0	3	0	(Inclusive of 50 per cent sur-charge).	1 8 0
From 1-4-1950	2,500	0	2	3	Ditto	1 2 0

163. 3. *Extraordinary Increase in Incidence because of Change in Method of Collection.*—Great as has been the tyranny of the repeated increases in stamp duty, it has been dwarfed by the extraordinary increase in incidence that has actually taken place because of the change in the method of collection. Before 1938, contract notes rendered by members of the Stock Exchange to their constituents, either as agent to principal or as principal to principal, were required to be stamped at the prescribed rates. There was a shortfall of revenue in 1938 after the introduction of prohibition.* With a view to co-operating with the national Government then in office, the system of collecting stamp duty through the Stock Exchange Clearing House was devised and a new Article 20-A was added to Schedule I of the Indian Stamp Act. Under this Article, clearance lists submitted by members were required to be stamped and contract notes corresponding to the entries made in the clearance lists were exempted from stamp duty by providing suitable exemptions under Articles 5(b) and 43(b). The object was admittedly not to impose a fresh tax but to prevent leakage of stamp duty. The operation of the new system did not create any special problems in so far as contracts rendered by members to

their constituents either as principal to principal under Article 5(b) or as agent to principal under Article 43(b) were concerned. Unexpectedly, this method of collecting the stamp duty vastly enlarged its scope and resulted in tax being levied on innumerable intermediate put-through and taravni transactions which being in the nature of "rajuats" were formerly altogether free from taxation. A proposal made in 1932 to tax such "rajuats" was abandoned when its true nature was realised. Since, however, for purposes of Clearing House returns, each of these numerous purchases and sales took the technical form of an entry in the Clearance Lists, the entire series of intermediate purchases as well as sales became subject to tax from one end to the other and the amount of stamp duty payable mounted up by leaps and bounds at an alarming pace. In fact, the stamp duty ceased to be a stamp duty as ordinarily understood. It was converted into a steamroller tax on the very method and machinery of business levied at usurious rates. It is this engine of oppression that is at work today crushing down the Stock Exchanges.

163. 4. *Stamp Duty Rates Inordinately High Compared with Other States.*—Not only is the system of collecting the stamp duty oppressive and unjust because of its unrestricted scope but the rates of stamp duty are also the highest in Bombay compared with other States. Table No. 163. II presents a comparative

* See para. 35.7 of the Reply to Part I of the Questionnaire.

TABLE NO. 163. II.

State	Stamp Duty on Contracts of Purchase and Sale of Shares					
	Scale of Duty				On a Transaction of Rs. 20,000	
	Unit Rs.	Rs.	A.	P.	Rs.	A. P.
Bombay	2,500	0	2	3	Inclusive of 50 per cent Sur-charge.	1 2 0
Madras	5,000	0	2	0		0 8 0
West Bengal	10,000	0	2	0		0 4 0

picture. It shows that the rate of stamp duty on contracts relating to purchase and sale of shares as charged in Bombay State is 450 per cent. higher than in Bengal and 225 per cent. higher than in Madras. The hardship involved is all too obvious.

163. 5. *Stamp Duty on Stock Exchanges Highest Compared with Other Markets.*—Not only is the stamp duty inordinately high in Bombay compared with other States, the Stock Exchanges are also the most heavily taxed compared with other forward markets in the State itself from the point of view of rate per unit as well as the incidence of the tax. A comparative state-

ment appears in Table No. 163. III. It clearly indicates the discrimination against the Stock Exchanges. The actual incidence of the stamp duty is much higher in the case of Stock Exchanges, depending on the period for which a transaction is carried over. The Stock Exchanges have fortnightly settlements whereas, for example, the Bullion Association has monthly settlements and the Cotton Exchange has five settlements in a year. Assuming that a transaction of the same value is carried over a uniform period, say, of one year in all the three markets, the Stock Exchange transaction would be subjected to a stamp duty about 210 per cent. and

TABLE No. 163. III.

Market	Bombay State Stamp Duty on Contracts of Purchase or Sale				
	Scale of Stamp Duty				Stamp Duty on a common Unit of Rs. 50,000
	Unit	Current Market Rate	Current Market Value of Unit	Stamp Duty Per Unit Inclusive of 50 per cent Surcharge	
			Rs.	Rs. A. P.	
Stock Exchange	Rs. 2,500		2,500	0 2 3	2 13 0
Bullion—					
Gold	250 Tolas	Rs. 85 per Tola	21,250	0 12 0	1 12 0
Silver	2,500 Tolas	Rs. 160 per 100 Tolas	4,480	0 3 0	2 1 0
Artificial Silk	Rs. 2,500		2,500	1 6 0	1 14 0
Edible Oils	Rs. 2,500		2,500	1 6 0	1 14 0
Spices	Rs. 2,500		2,500	1 6 0	1 14 0
Groundnuts	25 Tons	Rs. 36 per cwt.	18,000	0 9 0	1 9 0
Linseed	25 Tons	Rs. 29 per cwt.	14,500	0 7 6	1 9 0
Castor Seeds	25 Tons	Rs. 25 per cwt.	12,500	0 6 0	1 8 0
Cotton	50 Bales	Rs. 730 per Khandy (2 Bales).	13,250	0 6 0	1 1 0

190 per cent. higher than the transaction in gold and silver respectively and 1,140 per cent. higher than the transaction on the Cotton Exchange. This can be seen from Table No. 163. IV. The inequity of the burden cast on the Stock Exchanges needs no further comment.

TABLE No. 163. IV.

Market	Number of "Budlas" or "Carry-over" in a year	Total Amount of Stamp Duty (Inclusive of 50 per cent Surcharge) in Bombay State on a transaction of Rs. 50,000 carried over during the period of one year
		Rs. A. P.
Stock Exchange	24	137 13 0
Bullion—		
Gold	12	43 12 0
Silver	12	53 2 0
Artificial Silk	12	46 14 0
Cotton	5	11 1 0
Castorseeds	2	7 8 0

163. 6. *Contract Stamp Duty Payable in Addition to Share Transfer Stamp Duty.*—In contrast to the exemption enjoyed in the case of other goods like cotton, gold or silver, the purchaser of stocks and shares has to pay a transfer stamp duty at the rate of Re. 1-2 as. per cent. of the consideration amount when registering the documents in his name. How heavily this charge bears on the investor has been shown in answer to Question No. 162 above. The charge has to be paid over and above the stamp duty payable on the contract in respect

of purchase of shares. The discrimination practised against the Stock Exchange is thus sharply accentuated and the total incidence of the stamp duty is further increased.

163. 7. *Stamp Duty—a Multiple Tax on the Method and Machinery of Business.*—It has been pointed out in para. 163. 3 that the stamp duty as it is collected at present imposes a tax not only at the end of a chain of transactions but at both the ends of each and every link of one single chain. The link may be (a) a "put-through" transaction, or (b) a "carry-over" transaction, or (c) a "taravni" transaction, or (d) an arbitrage transaction, or (e) an ordinary bargain in the market, but as explained hereunder, in each and every case the transaction is subjected to multiple taxation—and that too at penal and discriminatory rates—in flagrant violation of all recognised principles of taxation:

(a) *Put-through transaction.*—Business put through by a broker on behalf of another is deemed to be a separate contract and taxed accordingly. In effect, instead of entering into the purchase or sale himself, a broker asks a colleague to share the commission and execute the order. Though there is one single transaction earning one single brokerage, technically there are two contracts, and the stamp duty involved is therefore increased 100 per cent.

(b) *Carry-over transaction.*—Carry-over represents a simple credit operation, that of borrowing money or loaning stock, and yet it is taxed as heavily as an ordinary purchase or sale transaction because of the contract system in vogue. In fact, no new transaction takes place when carry-over is effected; there is only an extension of time for the performance of the original transaction. The brokerage earned by the member on such carry-over is purely nominal. Nevertheless, at each carry-over double duty is paid, on purchase as well as on sale, and a single transaction is subjected to multiple taxation. In Cotton, there are five carry-overs during a year and so the tax has to be paid ten times over; in Bullion, there are twelve carry-overs during a year and so the tax

has to be paid twenty-four times over; in Shares, there are twentyfour carry-overs during a year and so the tax has to be paid forty-eight times over again. The position is unquestionably unjust and oppressive. In the final analysis, as for put-through transactions so for carry-over transactions, the tax falls on the method and machinery of business and not on the transaction itself.

- (c) *Taravni transaction*.—Another instance of taxing the method and machinery of business is the burden falling on 'Taravni' transactions. 'Taravni' consists of rapid going in and out of the market for a small difference, be it profit or loss. The system, though liable to abuse at times, is essential for free and open trading on all forward Exchanges and is indispensable for the maintenance of market liquidity and continuity of prices. It is of the essence of Taravni that there should be a series of quick alternating purchases and sales in order to help on the smooth flow of securities from the original sellers to the ultimate purchasers. Formerly, such transactions attracted no stamp duty as they are recorded in the form of "rajuats". As explained in para. 163. 3 above, because of the system of stamping clearance lists at present in operation, all the innumerable intermediate Taravni transactions are now subject not only to tax but to tax at double the rate, and the tax has to be paid irrespective of whether the transaction results in a profit or ends in a loss. There is no magic formula available to the floor trader as he stands on the floor of the Exchange and makes his trade. Years of experience and the highest degree of natural aptitude in the business do not prevent him from incurring frequent losses. His aim therefore is not so much to avoid losses absolutely—for that is impossible—as to overbalance his losses with his profits. But every such trade attracts a double tax levy. It becomes a case of "heads I win, tails you lose" and the Taravniwalla has always to pay the tax as heavily on his losses as upon his profits. Such taxation cannot but be regarded as being repugnant to equity and good conscience.

- (d) *Arbitrage transaction*.—The heavy stamp duty also handicaps arbitrage business passing between Stock Exchanges. The dealer has to take the market risk. In addition, he is saddled with the stamp duty. Therefore, unless the divergence in rates ruling in the two markets becomes most marked, the dealer does not find it profitable to engage himself in arbitrage. The investor suffers as he loses the advantage of buying and selling his securities in the best market; the broker suffers as he loses his commission and arbitrage profit; and from the general point of view, the appearance of price disparity is far from healthy.

- (e) *Ordinary bargain*.—Because of the system of stamping clearance lists, contracts as principal to principal liable to a single stamp duty under Article 5(b) of Schedule I to the Indian Stamp Act are made subject to double stamp duty under Article 20-A. When broker A sells shares and Broker B buys them as principal to principal, there is only one contract and under Article 5(b) only that contract should be required to bear a stamp. Unfortunately, when completing the clearance lists, broker A is required to make a sale entry in his clearance list and broker B a purchase entry in his clearance list; with the result that double stamp duty has to be paid—on the sale as well as the purchase, though they represent reciprocal parts of one and the same contract. A similar contract entered into outside the floor of the Exchange is liable to a single stamp duty. Upto as recently as the 31st of March, 1953, there was this blatant discrimination against the members of the Stock Exchanges recognised by Government under the Bombay Securities Contracts Control Act, 1925. Law and equity both required that the position be rectified by exempting either purchases or sales from stamp duty in the case of recognised Stock Exchanges. Instead, when hard pressed, the anomaly was perpetuated in 1953 by doubling the rates of duty in respect of contracts entered into by persons other than members of recognised Stock Exchanges. Thus, in a ruthless bid for revenue,

one inequity was heaped on another. wrongs never make a right. The adverse crimination against the recognised Stock Exchanges has disappeared but the fact remains that transactions which are liable single stamp duty under Article 5(b) are made subject to double stamp duty under Article 20-A. It is contrary to a fundamental principle of law and against all accepted canons of equity that one and the same transaction should be taxed twice over.

The stamp duty in all the foregoing cases operates a tax on the method of trading and machinery of business. Seemingly, the tax levy is small enough and capable of yielding any dramatic or spectacular result. But its incidence has been insidious. It is eating the very vitals of the system and has become a powerful, if unseen, drag and brake on all legitimate business activity.

163. 8. *Crushing Burden of Stamp Duty on Stock Exchanges*.—The focus of the foregoing analysis centred on the stamp duty that has been actually paid by the Stock Exchange. Figures cry out louder than words. The extraordinary manner in which the burden of stamp duty has been increased is evident from Table No. 163. V. What the Stock Exchange was called up

TABLE No. 163. V.

Year	Stamp Duty on Transactions in shares settled through the Clearing House of the Stock Exchange, Bombay		Year
	Rs.	Rs.	
1926	21,440	24,20,580	1947-48
1927	34,584	16,35,470	1948-49
1928	46,744	21,52,202	1949-50
1929	34,668	21,14,188	1950-51
1930	20,130	20,51,811	1951-52
1931	14,640	9,04,649	1952-53
1932	23,902		
1933	60,655		
1934	1,04,224		
1935	1,60,710		
1936	1,52,560		
1937	2,99,482		
TOTAL	9,79,739	1,12,78,900	TOTAL

(Source: Clearing House of the Stock Exchange, Bombay.)

to pay in the aggregate in a round dozen years from 1926 to 1937, more than twice as much and sometimes more it has had to pay every single year and year after year in recent years. The tax now hangs like a millstone round the neck throttling the Stock Exchanges. Table No. 163. VI below carries the story one step forward. It sums up the experience of the Stock

TABLE No. 163. VI.
(In Lakhs of Rs.)

Year	Stamp Duty Revenue in Bombay State		
	The Stock Exchange Bombay	All other Markets in Bombay State	Total
1947-48	24,20,580	3,03,779	27,24,359
1948-49	16,35,470	20,54,484	36,89,954
1949-50	21,52,202	21,44,860	42,97,062
1950-51	21,14,188	27,90,402	49,04,690
1951-52	20,51,811	39,13,431	59,65,242
1952-53	9,04,649	30,95,351	40,00,000

(Source: Bombay State Budgets and Clearing House of the Stock Exchange, Bombay.)

Exchange in Bombay compared with other forward markets. Gross discrimination could scarcely have gone any further. Table No. 163. VII below (which is the same as Table No. 17 II commented upon in the answer to Question No. 17 of Part I of the Questionnaire) completes the tale. It shows at a glance the ravages of ruthless and unrelenting expropriation passing respectable under the name of a stamp duty tax. These are violent words to use: but they do no violence to facts. Only one conclusion is possible. It rings out in the words of Chief Justice John Marshall (*McCulloch vs. Maryland*—1812):

“The power to tax involves the power to destroy; the power to destroy may defeat and render useless the power to create.”

163. 9. *An Indictment*.—The points listed above constitute a formidable indictment of the tyranny of the penal stamp duty that is being levied at present on contracts relating to the purchase and sale of stocks and shares. The tax flouts at every point the three principal guides to rates of stamp duty recommended by the Indian Taxation Enquiry Committee (1924-25) as quoted in para. 162. 2. It is clear beyond dispute that—

- The duty is in breach of the first principal guide in that it is the machinery of trade, the apparatus and operational method of business that for the most part is being subjected to tax at extortionate rates, irrespective of whether it earns brokerage or not, or results in a profit or ends in a loss. A tax of such magnitude and character is unconscionable and unjust and repugnant to public policy.
- The duty is in breach of the second principal guide in that the penal rates have carried it far beyond the point of diminishing returns. This notwithstanding, the Stock Exchange is still being singled out for invidious discrimination in comparison with other forward markets.
- The duty is in breach of the third principal guide in that it inflicts wanton damage and hardship on a particular class of the community, namely, those belonging to the stock-broking profession. The Stock Exchange is being taxed beyond capacity and its resources have been strained to the breaking point.

163. 10. *Conclusions*.—The facts as outlined point to the same conclusions, namely—

- That the multiple taxation of intermediate transactions constituting the method and machinery of business should be abolished *in toto*.
- That dual taxation of purchase as well as sale representing reciprocal parts of one and the same transaction should also be abolished *in toto*.
- That irrespective of the mode of collection—whether by stamping clearing lists or otherwise—, only the end transactions covered by contracts issued by brokers to constituents, either as principal to principal under Article 5(b) or as agent to principal under Article 43(b), should be subject to stamp duty, as used

to be the case before and as is still the case in all States other than Bombay.

- That the stamp duty as in (c) above should be at a uniform rate for all markets and in all States.
- That the stamp duty surcharge should be abolished *in toto* and that the basic stamp duty should be drastically reduced and fixed at a moderate rate, say, not exceeding 2 as. for every Rs. 10,000 of the consideration amount in respect of stocks and shares.

ADDENDUM TO THE REPLY OF THE STOCK EXCHANGE, BOMBAY, TO QUESTION 50 OF THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

50. 1-A. *Meaning and Mechanism of Bonus Issue*.—The true meaning of a bonus issue has been explained in detail in the answer to Question 50 of the Questionnaire, to which this is an addendum. Briefly, a Company accumulates reserves out of profits of previous years not distributed among the shareholders. These undistributed profits belonging to the shareholders have borne income-tax at the full rate plus super-tax in the year in which they have been earned. They also enter into the market price of the shares of the Company as quoted on the Stock Exchange. When a bonus issue is made, a simple book entry is passed whereby the undistributed profits appearing under the heads of some Reserve accounts are classified under the head Share Capital account. The assets continue to remain with the Company and what happens is a mere change in form and not in substance. The process or method of making a bonus issue is as simple as, and identical in all respects to, changing a ten-Rupee note for two five-Rupee notes or ten one-Rupee notes. That, however, is not to say, and does not and should not be taken to mean, that a ten-Rupee or five-Rupee or one-Rupee note is the same thing as a share or scrip. The value of a currency note was the same yesterday what it is today and will remain the same tomorrow or the day after or a year hence. On the other hand, the value of a share may have been different yesterday from what it is today, will probably be different tomorrow and altogether different a month hence or a year hence. This happens to a share irrespective of whether there is a bonus issue or no bonus issue. The point is important and must be remembered because failure to appreciate it directly contributes to the misconception that a bonus issue creates certain special advantages that would not otherwise accrue, namely:—

- that the total price of the Ex-bonus Ordinary share plus proportionate portion of the bonus issue goes up substantially in value;
- that the combined dividend on the Ex-bonus Ordinary share and on the proportionate portion of the bonus issue attached to it also goes up substantially in total value;
- that the shareholders acquire a legal right to the accumulated reserves of the Company; and
- that a shareholder is able to dispose of a part of his holding without disposing of all his holding in the Company.

TABLE No. 163. VII.

Year							The Stock Exchange, Bombay			Bombay State—Brokers and Jobbers Assessed to Income-tax			
							No. of Active Members	Stamp Duty Paid		No. of Assessee	Net Income Free of Income-tax and Super- tax in Lakhs of Rs.	Income-tax and Super-tax paid	
								Total in Laks of Rs.	Per Active Member Rs.			Total in Lakhs of Rs.	Per Assessee Rs.
1940-41	.	.	.	.	.	.	248	4.17	1,618				
1941-42	.	.	.	.	.	.	241	4.11	1,704	730*	68.82	15.94	2,180
1947-48	.	.	.	.	.	.	321	24.21	7,541	1172	100.57	36.34	3,100
1948-49	.	.	.	.	.	.	326	16.36	5,057	1033	113.13	59.22	5,733
1949-50	.	.	.	.	.	.	326	21.52	6,602	1005	100.31	39.86	3,966
1950-51	.	.	.	.	.	.	326	21.14	6,485				
1951-52	.	.	.	.	.	.	318	20.52	6,452				
1952-53	.	.	.	.	.	.	294	9.05	3,077				

* Estimated. Total Number for All-India 1,153.

(Source :—Central Board of Revenue, All-India Income-tax Revenue Statistics, 1941-42 to 1949-50, and Clearing House of the Stock Exchange, Bombay.)

These issues may be examined in the light of actual facts.

50. 2-A. *Variation in Price Between Cum-Bonus and Ex-Bonus Dates.*—It has been stated in para. 50. 1 of the answer to Question 50 of Part II of the Questionnaire that as the bonus issue merely represents a book entry, pure and simple, it does not of itself either add to or take away from the intrinsic value of the share from the financial point of view. This has been illustrated by the data presented in Table No. 50. I which shows the last *Cum-bonus* and the first *Ex-bonus* rates of shares quoted on the Bombay Exchange in respect of which bonus issues have been made during the last decade. The data is repeated and the hypothetical *Ex-bonus* rates based on the assumption that there has been no change in market price from the last *Cum-bonus* rates are recorded in column 4 of Table No. 50. I-A below. The percentage increase or decrease in value between these hypothetical *Ex-bonus* rates and the actual *ex-bonus* rates is worked out in the last column. The Table indicates—

(a) that, after the bonus issue, prices have moved both ways, up as well as down ;

- (b) that in 25 out of 46, that is, 54 per cent. of the cases, prices have gone up ;
- (c) that of the remaining 21, that is, 46 per cent. of the cases, in 3 cases prices have remained stationary and in the other 18 cases prices have gone down ;
- (d) that the range of fluctuation in either direction has been from + 18 per cent. to -16 per cent ;
- (e) that the average rise in prices has been 5 per cent. and the average fall 3.8 per cent., giving an over-all average increase in price, after the bonus issue, of as little as 1.2 per cent ;
- (f) that, by and large, the percentage variation in price in either direction has been small ;
- (g) that in the few cases where the percentage increase or decrease in value is large, the variation is exaggerated by exceptional factors other than bonus issue, as explained in the Analytical Note to Table No. 50. I-A ; and

TABLE NO. 50. I-A.

Ordinary share of	Ratio between old shares and bonus shares		Last <i>Cum-bonus</i> Rate	Hypothetical <i>Ex-bonus</i> Rate based on Last <i>Cum-bonus</i> Rate	First <i>Ex-bonus</i> Rate	Percentage increase or decrease in First <i>Ex-bonus</i> Rate over the Hypothetical <i>Ex-bonus</i> Rate
	Old	Bonus	Rs. A.	Rs. A.	Rs. A.	Per cent
1944						
Poddar Mills	5	1(P)	480 0	460 0	441 0	-4.1
1946						
Madhusudan Mills	1	1(P*)	587 8	555 0	550 0	-0.9
Walchandnagar Industries	1	1	835 0	418 0	429 0	2.6
1947						
Madhusudan Mills	2	1	435 0	290 0	300 0	3.4
Mysore Mills	3	1	285 0	214 0	240 0	12.1
Wimco	1	1	653 12	327 0	275 0	-15.9
Poona Electric	4	1	205 0	164 0	170 0	3.6
Walchandnagar Industries	1	1	310 0	155 0	165 0	6.4
Bombay Dyeing	1	1	2,070 0	1,035 0	1,030 0	-0.4
Century Mills	1	1	975 0	487 0	500 0	2.6
Simplex Mills	2	1	333 0	222 0	225 0	1.3
Premier Const.	1	1(P**)	271 0	261 0	264 0	1.1
1948						
Ahmedabad Advance	1	1	565 0	282 0	270 0	-4.2
Coorla Mills	1	1	300 0	150 0	147 0	-2.0
Laxmi Cotton	1	1	1,590 0	795 0	800 0	0.6
Minerva Mills	5	1	192 8	160 0	188 12	17.9
Sassoon Silk Mills	2	3	77 8	31 0	29 8	-5.0
Shrinivas Mills	1	1	460 0	230 0	230 0	—
Standard Mills	1	1	580 0	290 0	250 0	-13.7
Vishnu Mills	1	1	630 0	315 0	320 0	1.5
Bombay Sub. Elec.	8	1	150 10	133 0	137 8	3.3
Poona Elec.	7	1	150 0	131 0	145 0	10.6
Alembic Chemicals	4	1	257 8	206 0	205 0	-0.4
Indore-Malwa Mills	2	3	510 0	204 0	205 0	0.4
Morarji Goculdas	1	1(P)	601 4	500 0	490 0	-2.0

P—Preference Share of Rs. 100.

P*—Preference Share of Rs. 12/8.

P**—Preference Share of Rs. 10.

TABLE No. 50. I-A—contd.

Ordinary share of	Ratio between old shares and bonus shares		Last Cum-bonus Rate		Hypothetical Ex-bonus Rate based on Last Cum-bonus Rate		First Ex-bonus Rate		Percentage increase or decrease in First Ex-bonus Rate over the Hypothetical Ex-bonus Rate	
	Old	Bonus	Rs.	A.	Rs.	A.	Rs.	A.	Per cent	
1948—contd.										
New Great Mills	1	1	363	0	182	0	175	0	—3·8	
Kohinoor Mills	1	1	628	0	314	0	318	0	1·2	
Swadeshi Mills	1	1	609	0	305	0	299	0	—1·9	
Century Mills	1	1	531	4	266	0	270	0	1·5	
Belapur Sugar	4	1	347	0	277	0	278	0	—	
Premier Const.	1	3(P**)	219	8	189	8	199	0	4·7	
1949										
Indian Mfg. Mills	1	1(P@)	4,150	0	3,150	0	3,025	0	—3·9	
Western India Spg. Mills	1	1(P@)	4,070	0	3,070	0	2,925	0	—4·7	
Wimco	7	3	282	8	197	12	196	4	—0·7	
Swadeshi Mills	4	1	292	0	233	8	240	0	2·7	
1950										
Bombay Dyeing	1	1	1,060	0	530	0	540	0	1·8	
Morarji Goculdas	1	2	435	0	145	0	144	0	—0·6	
1951										
Shrinivas Cotton	4	1	195	0	153	0	177	8	13·4	
1952										
Elphinstone Mills	5	1	51	0	42	0	42	0	—	
Simplex Mills	2	1	274	0	183	0	185	0	1·1	
1953										
Polson	5	1	111	0	92	0	109	0	18·4	
Finlay Mills	4	1	321	0	257	0	250	0	—2·7	
Swan Mills	2	1	462	8	308	0	305	0	—0·9	
Wimco	4	1	237	8	190	0	195	0	2·6	
Simplex Mills	3	1	168	0	126	0	135	0	7·1	
1954										
Associated Cement	5	1	176	12	147	0	150	0	2·1	

P**—Preference Share of Rs. 10.

P@—Preference Share of Rs. 1,000.

Analytical Note to Table No. 50. I-A.

The percentage increase or decrease in actual Ex-bonus Price over Hypothetical Ex-bonus Price (based on last Cum-bonus Price) appears in the last column of Table No. 50. I-A, which may be analysed as under :—

Variation between Cum-bonus and Ex-bonus rates	No. of cases	Total of Percentages	Average Percentage
Percentage Increase in Price	25	+ 124·0	+ 5·0
Percentage Decrease in Price	18	— 67·8	— 3·8
Price Stationary	3	—	—
TOTAL	46	+ 56·2	+ 1·2

The over-all average increase in price after the bonus issue is as little as 1.2 per cent.

Individual shares in which the percentage price increase or decrease exceeds 10 per cent. are listed hereunder:—

No.	Ordinary shares of	Percentage Increase (+) or Decrease (—) per cent	Number of transactions during year of bonus issue
1.	Mysore Mills	+12.1	6
2.	Minerva Mills	+17.9	15
3.	Poona Elec.	+10.6	26
4.	Shrinivas Mills	+13.4	11
5.	Polson	+18.4	6
	TOTAL	+72.4	
1.	Wimco	—15.9	

The large drop of 15.9 per cent. in Wimco accounts for a fourth of the total percentage drop of 67.8 per cent. in 18 shares. This sharp drop in Wimco after the bonus issue was directly due to an exceptional factor, namely, the Liaquat Ali Khan Budget crisis on the Stock Exchange.

Similarly, the large total percentage rise of 72.4 per cent. in 5 shares accounts for three-fifths of the total percentage rise of 124 in 25 shares. This sharp rise is explained by the well-known fact that the five shares in question are amongst those which have an extremely narrow or restricted market, that is, a market in which buyers and sellers are so few that transactions barely take place once a month or once in even two or three months (see column 4 of the sub-Table) so that there is no continuity in price, the variation from the last quoted price being large ordinarily at all times.

If the 6 shares, in which the price variations are obviously the result of the foregoing peculiar or exceptional factors, are not taken into account, the position is as under:—

Variation between Cum-bonus and Ex-bonus ratios	No. of cases	Total of Percentages	Average Percentage
Percentage Increase in Price	20 (25.5)	+ 51.6 (124.0-72.4)	+2.6
Percentage Decrease in Price	17 (18.1)	—51.9 (67.8-15.9)	—3.1
Price Stationary	3	—	—
TOTAL	40	—0.3	0.0

The over-all average percentage variation in price after the bonus issue is zero in all ordinary cases, indi-

cating that a bonus issue confers no significant price advantage.

TABLE NO. 50. I-B.

Ordinary share of	Ratio between old shares and bonus shares	Rate on the date of intimation to the Stock Exchange of the bonus issue	Last Cum-bonus rate	Percentage increase or decrease in price between date of intimation of bonus issue and date of last Cum-bonus rate	Illustrative examples of percentage increase in price during the period in respect of shares for which there was no bonus issue
	Old Bonus	Rs. A.	Rs. A.	Per cent.	Ord. share of Per cent.
1944					
Poddar Mills	5 1(P)	507 8	480 8	—5.3	
1946					
Madhusudan Mills	1 1(P*)	492 8	567 8	15.3	{ Colaba Mill 23 Tata Chemical 15
Walchandnagar Industries	1 1	730 0	835 0	14.4	{ Khatau Mills 25 Finlay Mills 15
1947					
Madhusudan Mills	1 1(P*)	590 0	435 0	—26.3	
Mysore Mills	3 1	300 0	285 0	— 5.0	
Wimco	1 1	705 0	653 12	— 7.3	
Poona Electric	4 1	205 0	205 0	—	
Walchandnagar Industries	1 1	290 0	310 0	6.9	{ Alcock Ashdown 15 Vulcan Ins. 7
Bombay Dyeing	1 1	2,650 0	2,070 0	—21.9	
Century Mills	1 1	1,060 0	975 0	— 8.0	
Simplex Mills	2 1	326 0	333 0	2.2	{ Indore Malwa 22 Central India 9
Premier Const.	1 1(P**)	316 0	271 0	—14.3	

P—Preference Share of Rs. 100. P*—Preference Share of Rs. 12/8. P**—Preference Share of Rs. 10.

TABLE No. 50. I-B—contd.,

Ordinary share of	Ratio between old shares and bonus shares		Rate on the date of intimation to the stock Exchange of the bonus issue		Last Cum-bonus rate	Percentage increase or decrease in price between date of intimation of bonus issue and date of last Cum-bonus rate	Illustrative examples of percentage increase in price during the period in respect of shares for which there was no bonus issue			
	Old	Bonus	Rs.	A.			Rs.	A.	Per cent.	Ord. share of	Per cent.
1948										
Ahmedabad Advance	1	1	600	0	565	0	— 5.8			
Coorla Mills	1	1	282	8	300	0	6.8	{ Indian Iron	10	
								{ Poddar Mills	7	
Laxmi Cotton	1	1	1,610	0	1,590	0	— 1.2			
Minerva Mills	5	1	210	0	192	8	— 8.3			
Sassoon Silk	2	3	77	8	77	8	—			
Shriniwas Mills	1	1	460	0	460	0	—			
Standard Mills	1	1	580	0	580	0	—			
Vishnu Mills	1	1	602	8	630	0	4.6	{ Century Mills	19	
								{ Dharamsi M. Chemical	7	
Bombay Sub. Elec.	8	1	148	12	150	10	1.3	{ Bombay Burmah	5	
								{ Ajmer Elec.	3	
Poon Elec.	7	1	150	0	150	0	—			
Alembic Chemicals	4	1	243	12	257	8	5.6	{ Walchandnagar Industries	17	
								{ New City Mills	9	
Indore-Malwa Mills	2	3	497	8	510	0	2.5	{ Colaba Mills	20	
								{ Alecock Ashdown	12	
Morarji Goculdas	1	1(P)	527	8	601	4	13.9	{ A. C. C.	18	
								{ Elphinstone Mills	16	
New Great Mills	1	1	396	0	363	0	— 8.3			
Kohinor Mills	1	1	603	0	628	0	4.1	{ Bombay Steam	11	
								{ Poddar Mills	5	
Swadeshi Mills	1	1	661	0	609	0	— 7.8			
Century Mills	1	1	527	8	531	4	0.7	{ Tata Oil	7	
								{ Finlay Mills	5	
Belapur Sugar	4	1	344	0	347	0	0.8	{ Tata Power	15	
								{ Andhra Valley	4	
Premier Const.	1	3(P**)	238	0	219	8	— 7.7			
1949										
Indian Mfg. Mills	1	1(P@)	4,150	0	4,150	0	—			
Western India Spg. Mills	1	1(P@)	4,070	0	4,070	0	—			
Wimco	7	3	257	8	282	8	9.7	{ Indian Iron	20	
								{ Central Bank	10	
Swadeshi Mills	4	1	294	8	292	0	— 0.8			
1950										
Bombay Dyeing	1	1	963	12	1,060	0	9.9	{ New Great Mills	25	
								{ Century Mills	12	
Morarji Goculdas	1	2	446	4	435	0	— 2.5			
1951										
Shriniwas Cotton	4	1	195	0	195	0	—			

TABLE No. 50 I-A—contd.

Ordinary share of	Ratio between old shares and bonus shares	Rate on the date of intimation to the Stock Exchange of the bonus	Last Cum-bonus rate	Percentage increase or decrease in price between date of intimation of bonus issue and date of last cum-bonus rate	Illustrative examples of percentage increase in price during the period in respect of shares for which there was no bonus issue
	Old Bonus	Rs. A.	Rs. A.	Per cent.	Ord. Share of Per cent.
1952					
Elphinstone Mills	5 1	52 0	51 0	— 2.0	
Simplex Mills	2 1	257 0	274 0	6.6	{ Shivrajpur 22 Finlay Mills 9
1953					
Polson	5 1	111 0	111 0	—	
Finlay Mills	4 1	320 0	321 0	—	
Swan Mills	2 1	435 0	462 8	6.3	{ National Rayon 8 Gokak Mills 7
Wimco	4 1	230 0	237 8	3.2	{ Scindia 9 Tata Chemical 7
Simplex Mills	3 1	180 0	168 0	— 6.6	
1954					
Associated Cement	5 1	186 12	176 12	— 5.3	

(h) that, eliminating these few exceptional items, the variation in price is about 2.5 per cent. to 3 per cent. in either direction with an over-all average percentage price variation equal to zero, indicating that the price variation following a bonus issue has no special significance but merely represents the normal fluctuation that takes place between any two dates in the price of any share irrespective of whether there is a bonus issue attached to it or not.

These conclusions are confirmed in the following paragraph where the analysis is elaborated in greater detail.

50. 3-A. *Variation in Value Between Dates of Bonus Issue Announcement and Last Cum-Bonus Rate.*—It has been suggested that the last Cum-bonus rate itself is the result of adjustments that take place in the period following the announcement of the bonus issue and that therefore the advantage of the rise in prices accruing from the bonus issue should be measured with reference to these adjustments. Table No. 50 I-B (pp. 6-7) records the change in rates between the date on which intimation of the bonus issue was given to the Stock Exchange and the date of the last Cum-bonus rate. The percentage rise or fall in prices is worked out in column 5 and against those shares in which there has been a rise are set out in the last column a few illustrative examples of price increase in other shares quoted on the Exchange in respect of which there were no bonus issues. Like Table No. 50. I-A, Table No. 50. I-B also indicates—

- that, after the date of intimation of the bonus issue, prices have moved both ways, up as well as down;
- that in 18 out of 46, that is, 39 per cent. of the cases, prices have gone up;
- that of the remaining 28, that is, 61 per cent. of the cases, in 10 cases prices have remained stationary and in the other 18 cases prices have gone down;
- that the range of fluctuation in either direction has been from +15 per cent. to -26 per cent.;
- that the average rise in price has been 6.4 per cent. and the average fall 8 per cent., with an over-all average percentage price variation of as little as— $\frac{1}{2}$ per cent., indicating that the price variation following the announcement of a bonus issue has no special

significance but merely represents the normal fluctuation that takes place between any two dates in the price of any share irrespective of whether it carries a bonus issue or not; and

- that this conclusion corresponds to actual market experience because, in each case when there has been a percentage increase in the value of a share following upon the announcement of a bonus issue, prices of some other shares quoted on the Exchange but not carrying any bonus issue have also witnessed a parallel rise over exactly the same period, confirming the fact that the price increase is not the result of the bonus issue but of market factors that are constantly in operation irrespective of whether there is a bonus issue or not.

50. 4-A. *Bonus Issue confers no significant Price Advantage.*—The inference that can be drawn from the foregoing paragraphs is the obvious one. Fundamentally, from the financial point of view, a bonus issue makes no inevitable addition to the intrinsic value of the share to which it is attached. Prices sometimes rise and sometimes fall after a bonus issue and the rise or fall is the outcome of a large number of factors. Some of these factors are capricious, emotional and unpredictable, others relate to the progress of industry, earnings of individual companies and the like, and yet others are of long-term duration such as the trade cycle, variations in interest rates, change in money values, etc. It is not as if the fact of the bonus issue escapes the vigilant eyes of the market crowd, ever on the watch for what are, after all, such "juicy bits" from the psychological point of view. Some propagate the view that the Company's position must have been stabilised and that there is a prospect of future improvement and better results. Others may hold the outlook to be unsatisfactory and fear a cut in dividends because undistributed profits once capitalised cannot be drawn upon in the future for dividend distribution. Simultaneously, a medley of other influences is at work. A "shop" may be buying or unloading the share and a number of people engaged in market operations some on the bull and the others on the bear tack. The pattern of price fluctuations depends entirely on how the long-term trend, the intermediate trend, the cyclical trend, the secondary trend and the tertiary trend happen to coincide at a particular moment of time or on particular dates. The particular and the general causes are so completely inter-mingled in the price of a share that

it is impossible to isolate the precise psychological influence of a bonus issue and claim for it a determined and well-defined price advantage which can be measured in practice and made the subject matter of a special tax. Any such attempt is therefore bound to be arbitrary and wholly misconceived.

50. 5-A. *Variation in Dividend paid before and after Bonus Issue.*—The second point put forward in connection with a bonus issue is that the combined dividend on the *Ex*-bonus share and on that portion of the bonus issue to which it is entitled is always higher than the dividend paid previous to the bonus issue, and further that, the dividend is so much higher that, if the same total amount were distributed without making a bonus issue, it would raise the rate of dividend per share to a level that would not be tolerated by public opinion. Table No. 50 I-C (pp-10-11) records the dividend per share paid during the year immediately preceding the date of the bonus issue and the combined dividend paid on the *Ex*-bonus share and on the proportionate portion of the bonus issue attached to it during the year immediately following the date of the bonus issue. The percentage increase or decrease in dividend is worked out in column 5 and in the last column there appear a few illustrative examples of a parallel percentage increase in dividends during the

same period on other shares quoted on the Exchange in respect of which there were no bonus issues. As in the case of other Tables, Table No. 50. I-C also indicates—

- that, after the bonus issue, dividends have moved both ways, up as well as down;
- that, in 24 out of 45, that is, 53 per cent. of the cases, dividends have gone up;
- that of the remaining 21 that is 47 per cent. of the cases, in 10 cases dividends have remained stationary and in the other 11 cases dividends have gone down;
- that, in cases where dividends have gone up, by and large the increase has been moderate; and
- that, even in comparison with cases where the percentage increase has been large, there are other shares also quoted on the Exchange but not carrying a bonus issue in respect of which as well dividends have recorded a parallel percentage increase during the same period, indicating that there is nothing so extraordinary in a high rate of dividend per share as to cause shareholders to make a bonus issue with the object of avoiding so-called public censure.

TABLE No 50. I-C.

Ordinary share of	Ratio between old shares and bonus shares		Dividend on Cum-bonus Ordinary share in year immediately preceding date of bonus issue		Combined div. on Ex-bonus Ord. share plus div. on proportionate portion of bonus issue in year immediately following date of bonus issue		Percentage increase or decrease in the dividend following the bonus issue	Illustrative examples of percentage increase in dividend during the period on shares in respect of which there was no bonus issue
	Old	Bonus	Rs.	A.	Rs.	A.		
1944								
Po. Idar Mills	5	1(P)	10	0	10	13	8	Edward Textiles 50 Swadeshi Mills 40 Finlay Mills 25 Premier Const. 14
1946								
Madhusudan Mills	1	1(P*)	7	8	19	4	156	Khandesh Mills 200 Morarji Goculdas 108 Bombay Burmah 33
Walchandnagar Industries	1	1	24	11	6	3	75	Dharamsi M. Chemical 33 Kohinoor Mills 24
1947								
Madhusudan Mills	2	1	18	12	22	8	20	Colaba Mills 117
Mysore Mills	3	1	15	0	16	0	7	Edward Textiles 100
Wimco	1	1	12	0	24	0	100	Tata Mills 100
Poona Electric	4	1	9	0	10	4	14	Phoenix Mills 67
Walchandnagar Industries	1	1	6	3	20	0	222	New Great Mills 40
Bombay Dyeing	1	1	65	0	60	0	7½	Laxmi Cotton 33
Century Mills	1	1	23	0	46	0	100	Belapur Sugar 33
Simplex Mills	2	1	15	0	15	0	—	Bombay Burmah 25
Premier Const.	1	1(P**)	—	—	0	7	—	Broach Electric 17
1948								
Ahmedabad Advance	1	1	13	0	20	0	54	Broach Electric 100
Coorla Mills	1	1	15	0	15	0	—	Indian Iron 100
Laxmi Cotton Mills	1	1	100	0	75	0	25	Central India 83
Minerva Mills	5	1	12	0	11	6	5	Empire Insurance 50
Sassoon Silk Mills	2	3	3	0	3	7	15	Hindustan Safe Deposit 50
Shrinivas Mills	1	1	25	0	25	0	—	
Standard Mills	1	1	25	0	27	8	10	Indian Mfg. Mills 40

TABLE No. 50 I. C—contd.

Ordinary share of	Ratio between old shares and bonus shares	Dividend on Cum-bonus Ordinary share in year immediately preceding date of bonus issue	Combined div. on Ex-bonus Ord. share plus div. on proportionate portion of bonus issue in year immediately following date of bonus issue	Percentage increase or decrease in the dividend following the bonus issue	Illustrative examples of percentage increase in dividend during the period on shares in respect of which there was no bonus issue	
	Old Bonus	Rs. A.	Rs. A.	Per cent.	Ord. share of Per cent.	
1848—contd.						
Vishnu Mills	1 1	28 0	25 0	— 10	S. Madras Elec. 36 Indian Bleaching 33 British India General Ins. 33 Berar Mills 20 Modol Mills 20 Associated Cement 20 Alcock Ashdown 17 Meyer Mills † Bradbury Mills †	
Bombay Sub. Elec.	8 1	7 0	7 14	12		
Poona Elec.	7 1	9 0	10 5	14		
Alembic Chemicals	4 1	15 0	15 0	—		
Indore-Malwa Mills	2 3	20 0	20 0	—		
Morarji Goculdas	1 1(P)	22 0	24 0	9		
New Groat Mills	1 1	10 0	13 12	37½		
Kohinoor Mills	1 1	18 0	20 4	12½		
Swadeshi Mills	1 1	22 0	24 8	11		
Century Mills	1 1	23 0	15 0	— 35		
Belapur Sugar	4 1	12 0	10 7	— 13		
Premier Const.	1 3(P**)	—	4 11	†		
1949						
Indian Mfg. Mills	1 1(P@)	175 0	175 0	—	Jost's Eng. 150 Dharamsi M. Chemical 50 Indian Cements 37 Indian Iron 33 Khatau Mills 30	
Westorn India Spg. Mills	1 1(P@)	175 0	175 0	—		
Wimco	7 3	12 0	9 0	— 33		
Swadeshi Mills	4 1	12 4	17 8	43		
1950						
Bombay Dyeing	1 1	35 0	27 8	— 22	Bradbury Mills 400 Mysoro Mills 133 Kohinoor Mills 107 Century Mills 47	
Morarji Goculdas	1 2	20 0	44 8	122½		
1951						
Shriniwas Mills	4 1	12 8	17 8	40		
1952						
Elphinstone Mills	5 1	4 0	3 9	— 11	Tata Mills 100 India United 40 Kohinoor Mills 39 Sassoon Cotton 33	
Simplex Mills	2 1	22 0	24 0	9		
1953						
Polson	5 1	9 0	10 13	20	Central India 150 Shivrajpur 114 Cokak Mills 57 Seindia 50 New Union 25 Sassoon Cotton 25	
Finlay Mills	4 1	20 0	20 0	—		
Swan Mills	2 1	30 0	30 0	—		
Wimco	4 1	11 0	13 12	25		
Simplex Mills	3 1	15 0	14 11	— 2		
1954						
Associated Cement	5 1	9 8			Dividend not yet announced	

P—Preference Share of Rs. 100. P**—Preference Share of Rs. 10. P@—Preference Share of Rs. 1,000. †—No dividend in the previous year.

50. 6-A. *Bonus Issue confers no significant Dividend Advantage.*—It is apparent from the foregoing that dividends subsequent to a bonus issue have sometimes gone up and sometimes gone down and further that those Companies which made bonus issues and paid larger dividends (i.e., on the *Ex-bonus* original share and the proportionate portion of the bonus issue attached to it) could also have paid the same total amount of dividend without making a bonus issue by merely stepping up the rate of dividend per share exactly in the same way as the other Companies actually did. It therefore cannot be claimed that a bonus issue confers any special dividend advantage on shareholders which they otherwise do not or would not have. Dividends are a function not of bonus issue but of profits and the suggestion impugned apparently springs from a misapprehension of, or an ideological predilection against, industrial profits and dividends. In conditions of free competition, the trend of profits and dividends regulates the growth of industry and in a sense epitomises the prospects of future progress and expansion. Large dividends can be declared by a Company after making appropriate provisions only if the profits are sufficiently large and such good profits made by a Company in a competitive and free market economy are a sign of efficiency and vigorous health. For this it deserves to be congratulated and not to be condemned at the bar of public opinion which is what seems to be the popular pastime of politicians today. Let it be clearly understood that there is nothing wrong or immoral about such profits earned through dynamic initiative and efficiency and a courageous acceptance of risks—for it is out of such profits that the highest taxes are paid without which the State cannot function and again it is out of such profits that the productive capacity of the country is enlarged creating opportunities of employment and further economic development. In fact, profits and dividends go up as often as they go down irrespective of whether there is a bonus issue or not and to single out bonus issues for a special tax on the ground of some so-called dividend advantage to shareholders is nothing more and nothing less than to impose a special tax on investment and investors. Perhaps no other tax proposal could be less desirable or more injurious at the present stage of the country's economic development because putting money in share is but a means to an end, which is risk-taking in the field of industrial enterprise. For the community's sake, it is well that equity holders should strive (and at times succeed) for the profits that are to be won—after all, not without dust and heat.

50. 7-A. *Change in Legal Position After Bonus Issue.*—It has been shown above that a bonus issue merely represents a book entry whereby the amount previously standing under the head reserves appears in the balance sheet under the head capital and that this implies no change from the financial point of view. However, from the legal point of view, there are two implications and these may be examined. The reserves consist of profits belonging to shareholders which have been earned in the past but which have not been distributed as dividend though they have been fully taxed with income-tax at the maximum rate as well as super-tax from year to year as they have accrued. Such reserves remain available for paying dividends in subsequent years when times are bad or when the shareholders so choose. But when these reserves are capitalised by a bonus issue, they become a part of the capital of the company. As such, they cease to be available for distribution because in law the capital of a company cannot be reduced or drawn upon for paying dividends to shareholders. A bonus issue, therefore, restricts in this manner an important legal right of the shareholders. At the same time, however, it puts the seal on the legal title of the shareholders to assets to which they are fully entitled in equity, in the same way as by registering the shares with the company in his name a purchaser of shares completes his legal title to the property that belongs to him in equity. Just as the purchaser of shares, by registering them, makes his equitable title secure from doubt and safeguards himself against harassment in the future, so also by making a bonus issue the equity holders' interest in the equity of the company is safeguarded in law against possible piracy and expropriation in the future under the pressure of power politics. The Cawnpore Electric Supply Corporation award which was set aside by the Allahabad High Court and the more recent Madras Electric Tramways award which is under appeal before the Appellate Tribunal are striking instances of how easily the equity of the equity holders in a company can be destroyed. The point has been dealt with in para. 22.8 (h) of the answer to Question 22 in Part I of the Questionnaire, where the subject of saving, investment and progress of joint stock enterprise in relation to the economic development of the country has been discussed in some detail. It may be, therefore, concluded that from the legal point of view—

(a) a bonus issue does not so much create a new right as it enables shareholders to assure

themselves of legal protection of their existing equitable rights; and that

(b) it entails, at the same time, a measure of restriction on shareholders in that the reserves once crystallised as capital cease to be available for dividend distribution in future years because in law capital cannot be reduced or drawn upon for paying dividends.

The right to property has been recognised as a fundamental right of the citizen under Article 31 of the Constitution, and the investor is entitled to assume, and has the right to expect, at least that much of minimum protection in law for his property as comprehended in a bonus issue, as is generally available to holders of property in any other form. Accordingly, to levy, a special tax on bonus issues on the ground of some special so-called legal advantage is to discriminate against investors and shareholders, who on the contrary deserve, and should be given, active tax relief and concessions to promote and accelerate the process of capital formation without which there can be no rapid economic progress.

50. 8-A. *Disposal of Shareholding after Bonus issue.*—Lastly, it is put forward that the issue of bonus shares confers a special advantage on a shareholder in the sense that he is able to dispose of a part of his holding without disposing of his entire holding in the Company. The suggestion is based on some misunderstanding. The facility of disposing of any part or the whole of his holding is always available to all shareholders at all times in all shares irrespective of whether there is a bonus issue or no bonus issue. The Stock Exchange exists as an institution precisely for this purpose and the liquidity it imparts to shareholdings is acknowledged to be one of its primary and most important functions. The proposition that has been advanced perhaps holds true in that extreme case when an investor owns no more than one single share of a Company so that when he sells it off on the Stock Exchange he ceases to retain his interest in the Company. A bonus issue would enable such a shareholder, if he is desirous of reducing his stake in the Company, to dispose of a part of his holding which otherwise he would not be in a position to do. But barring such stray and solitary examples, when the holding of an investor consists of two or more shares—and this is the case with almost all investors—he can always sell off any part of his holding on the Stock Exchange. It is a fact of daily experience that shareholders do that with ease at a time or from time to time whenever they please and this happens in the case of all shares irrespective of whether there is a bonus issue or not. It follows that bonus shares confer no special advantage on shareholders in the matter of disposing of their holdings, as is sometimes claimed.

50. 9-A. *Conclusion.*—The main conclusions emerging from the foregoing analysis may be briefly stated:—

- (a) The profits of a Company are subject to income-tax at the maximum rate as well as super-tax in the year in which they are earned.
- (b) The profits so taxed but not distributed among shareholders as dividend are carried to reserves and enter into the price at which the shares of the Company are bought and sold by the public on the Stock Exchange.
- (c) A bonus issue capitalises the reserves, that is, a book entry is passed whereby the amount of undistributed profits previously standing under the head 'reserves' appear in the balance sheet under the head 'capital'—which represents a change in form but not in substance as the assets continue to remain with the Company.
- (d) Accordingly, a bonus issue confers on shareholders no special price advantage which they do not otherwise have in respect of shares not carrying a bonus issue. In actual fact, it is the experience that prices go down as often as they go up after a bonus issue exactly in the same manner as prices of shares not carrying a bonus issue, the movement in either direction depending on the state of the economy and the complex of long, medium and short term factors that are constantly at work on the Stock Exchange.
- (e) Similarly, a bonus issue confers on shareholders no special dividend advantage which they do not otherwise have in respect of shares not carrying a bonus issue. As in the case of prices, it is the experience in actual fact that dividends go down as often as they go up after a bonus issue exactly in the same manner as dividends on shares not carrying a bonus issue, the movement in either direction depending on innumerable factors comprising the state of the economy, the profitability of industry, the earnings of the parti-

cular concern, and the like. In conditions of a competitive and free market economy, there is nothing wrong or immoral, but on the contrary much to commend and welcome, when good dividends are paid by a Company as a result of larger profits earned through initiative, efficiency and bold acceptance of risks—for it is out of such profits that the highest taxes are paid without which the State cannot function and again it is out of such profits that the productive capacity of the country is enlarged, creating opportunities of employment and further economic development.

(f) From the legal point of view, a bonus issue does not so much create a new right as it enables shareholders to assure themselves of legal protection of their existing equitable rights by completing their title to the fully taxed but undistributed reserves that belong to them in equity, so that such assets, accumulated over years or acquired by them on the Stock Exchange for valuable consideration, are not pirated or expropriated at a future date under the pressure of power politics. The bonus issue, at the same time, entails a measure of restriction on shareholders in that the reserves once crystallised as capital cease to be available for dividend distribution in future years because in law capital cannot be reduced or drawn upon for paying dividends.

(g) Lastly, from the point of view of marketability, a bonus issue does not confer any special advantage on a shareholder in the matter of enabling him to dispose of a part of his holding without disposing of his entire holding in the Company. As is well known, this facility is always available on the Stock Exchange to all shareholders at all times in respect of all shares irrespective of whether they carry a bonus issue or not.

(h) It follows that there is no determined or ascertainable gain or unearned increment in price and/or dividend that bonus shares deliver to equity-holders automatically and inevitably, which could be made the subject matter of a special tax except on a fictitious and entirely arbitrary basis.

(i) Further, even assuming that there were any price, dividend or similar gain or advantage to shareholders following on a bonus issue, it would be nevertheless grossly inequitable to subject it to a special extra tax. The bonus issue itself is wholly constituted of accumulated undistributed profits which have been taxed from year to year not only with super-tax but also with income-tax at the full rate in respect of which no refund or credit is received by the shareholders as they would have received had the profits, instead of being accumulated, been distributed as dividend amongst them. The tax so paid, equivalent at the present rate of income-tax to 33 per cent. of the value of the entire bonus share, must exceed by far the whole of whatever increment or advantage in price, dividend or otherwise a bonus issue is claimed to confer on the shareholders. Any further tax, if levied, would therefore fall not on the assumed increment, even if it be deemed to accrue, but on capital itself.

(j) On the other hand, if bonus shares are treated as a part of the shareholder's income and taxed accordingly, that would be to tax a second time those very profits which, as pointed out in (i) above, have been taxed with income-tax at the full rate as well as with super-tax. Added to that would be another gross inequity, namely, that undistributed taxed profits earned and accumulated over a number of years would be impressed in a lump sum to income-tax and super-tax again in one single year, with all that must inevitably mean in terms of tax rating and the total tax exacted.

(k) It may be, therefore, concluded that a tax on bonus issues would be a tax not on income, nor again a tax on capital gains or profits, but a tax on capital itself, a tax on capital formed out of profits which themselves have been regularly taxed from year to year at the full rate of income-tax plus super-tax, a capital tax besides not levied generally but in unwarranted discrimination against a small group of investors, and in particular the small and middle-class shareholders, who have employed their savings gainfully in joint stock enterprise on which so much of the

progress and expansion of the country's economic development depends.

NOTE ON "BUYING" OF SPECULATION LOSSES

1. **The Problem and its Magnitude.**—The problem of buying speculation losses assumes significance from the point of view of income-tax evasion only when—

- (a) an assessee claims set-off of speculation loss against other income;
- (b) the assessee's other income is large; and
- (c) the proportion of speculation loss to other income is large.

Such cases can be picked out at sight and this at once limits the field of special investigation to a relatively small percentage of the total number of cases.

2. **Object of Investigation and the Crucial Test.**—The object of the special investigation is to determine whether the large speculation losses claimed by an assessee are—

- (a) genuine; or
- (b) bogus.

A speculation loss results in the ordinary course when a purchase is made at a higher price than the sale or what is the same thing when a sale is made at a lower price than the purchase, the sequence whether the purchase comes first or the sale being immaterial. As will be shown presently, the test to determine whether the speculation loss claimed is genuine or bogus is whether the purchase and sale contracts resulting in the large speculation loss are supported by corresponding transactions in the market with other brokers. If they are, the loss is genuine; if they are not, the presumption should be that the loss is bogus unless the assessee produces irrefutable evidence to the contrary.

3. **Genuine Speculation Losses—Process and Proof.**—Imagine that Assessee A places a bonafide order for purchase or sale with Broker X. When executing the order, Broker X in turn enters into a corresponding transaction in the market with Broker Y. Broker X then issues a contract note in the name of Assessee A against which there is the corresponding "Bazaar" contract between Brokers X and Y. Subsequently, Assessee A places a bonafide cross order for sale or purchase. Thereupon, Broker B executes the order in the market by entering into a corresponding transaction with Broker Z. Here again Broker X issues a contract note in the name of Assessee A against which there is the corresponding "Bazaar" contract between Brokers X and Z. If the purchase and sale made by Assessee A have resulted in a loss, that loss is genuine. Not only will there be contract notes issued by Broker X in the name of Assessee A but there will also be in support corresponding transactions in the market between Broker X on the one hand and Brokers Y and Z on the other. This will establish the fact that the speculation loss claimed by Assessee A is genuine.

4. **Bogus Speculation Losses.**—Bogus speculation losses, if claimed by Assessee A, cannot be supported by market transactions corresponding to the purchase and sale contract notes issued in his name by Broker X. For purposes of analysis, such bogus losses may be considered under two heads:

- (a) Paper losses artificially raised in Assessee A's account by means of fictitious entries and contract notes; and
- (b) Transfer of real losses from the person incurring such loss, say, B to Assessee A.

5. **Paper Speculation Losses—Method and Detection.**—Assessee A may claim speculation losses which have never really occurred and for this he takes the help of Broker X. As a loss arises only when the purchase rate is higher than the sale rate, old market quotations are scrutinized and two dates are selected—one on which the rate was high and the other on which the rate was low. Broker X then issues two contract notes in the name of Assessee A, a purchase contract for a given number of shares as of the date on which the rate was high and a sale contract for the same number of shares as of the date on which the rate was low. As the operation is an after-thought, there are and can be no corresponding transactions in the market with other brokers on the dates appearing on the spurious contract notes. Broker X has, therefore, to issue contracts to Assessee A either as principal to principal (in which case his own name occurs against the contracts issued in the name of Assessee A) or as agent to principal (in which case he is compelled to put the name of some other constituent, real or imaginary, against the contracts issued in the name of Assessee A). In neither case can the name of a "Bazaar" party, that is, of another broker appear against the purchase and sale contract notes issued to Assessee A because in fact on the dates in question corresponding transactions have not been entered into by Broker X in the market with other brokers, say, Y or Z. Such bogus paper losses can be, therefore, immediately detected.

6. Transfer of Real Speculation Losses—Method and Detection.—A genuine speculation loss may be suffered by a person, say, B and it may be "bought" by Assessee A through the help of Broker X. Since B's loss is genuine, there are corresponding purchase and sale transactions in the market so far as B is concerned. When B places his first order, whether of purchase or sale, Broker X executes it in the market with Broker Y and then issues a contract note in the name of B. The contract note cannot possibly be issued on that date in the name of Assessee A because when B places the first order with Broker X he does so in the expectation of making a profit and not with a view to incurring a loss for the purpose of "selling" it off to Assessee A at a later date. When B places his subsequent closing out order, that cross order is also executed by Broker X in the market with, say, Broker Z. Since the profit or loss stands determined on the execution of the closing out order, if B's business has resulted in a loss, he may "sell" off such loss to Assessee A there and then or a little later. If he "sells" off the loss immediately, instead of the contract note being issued by Broker X in the name of B, it may be arranged by B with Broker X to have such contract note issued in the name of Assessee A. Accordingly, two alternative positions may arise :

- (i) Broker X issues first contract in the name of B and the subsequent closing out contract also in the name of B (both these contracts being supported by corresponding transactions in the market) ; or
- (ii) Broker X issues first contract in the name of B and the subsequent closing out contract in the name of Assessee A (both these contracts being supported by corresponding transactions in the market).

If the position is as in (i) above, Assessee A is nowhere in the picture when B actually sustains the loss. The loss is later transferred from B to Assessee A and this is an after-thought. B is shown by Broker X to make a paper profit to cancel out the real loss sustained by him and that paper profit of B is at the expense of Assessee A who is shown by Broker X as making a paper loss. For the purpose of this paper profit and loss, the process of selecting appropriate dates and rates and passing fictitious contract notes has to be gone through in the manner explained in Para. 5 above. But as pointed out in that paragraph, since the fictitious contract notes issued by Broker X in the name of Assessee A will not be supported by corresponding transactions in the market with other brokers, the fraud will be easily detected. If the position is as in (ii) above, it is true that the second closing out contract will not have to be

transferred from B to Assessee A. But since the first contract issued by Broker X is in the name of B, at least this contract will have to be transferred. The fictitious contract issued for this purpose by Broker X to Assessee A will carry against it the name of B and will not be supported by the names of "Bazaar" parties as there will be no corresponding transactions in the open market with other brokers as far as Assessee A is concerned. No matter then whether B "sells" his speculation loss to Assessee A immediately after it is incurred or at a later stage, concealment will not be possible and the fraud will stand fully exposed.

7. Conclusions.—The conclusions can be briefly stated :—

- (i) To disallow all speculation losses as at present is to hit 75 per cent. to 80 per cent. of the bonafide trade. This is neither fair nor equitable, nor is it desirable as it is bound to do irreparable damage to the effective functioning of forward markets.
- (ii) Substantial evasion of income-tax through purchase of speculation losses is limited to a relatively very small percentage of the total number of cases. As their distinguishing characteristic is large claims for speculation losses as set-off against other income, suspicious cases can be easily picked out at sight for special investigation.
- (iii) Successful investigation of such suspicious cases should not present any insuperable difficulties, the speculation losses claimed being in general disallowed if the relative purchase and sale contracts are not found to be supported in the books of the brokers concerned by corresponding transactions in the open market with other "Bazaar" parties, that is, brother brokers.
- (iv) The problem, therefore, is one of efficient and honest administration. Draconian measures of the kind embodied in the recent amendments to Section 24(1) of the Indian Income-tax Act will not stop the evil (which, in a sense, will be legalised) but will ruin bonafide trade which in turn will also involve a substantial loss of revenue as there will be a steep fall in the quantum of speculation gains earned on which income-tax is being collected at present.
- (v) It follows from the foregoing that the amendments recently made in Section 24(1) of the Indian Income-tax Act should be repealed forthwith.

TAX PAYERS' ASSOCIATION OF INDIA, LTD.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART II—DIRECT TAXES.

Question 46.—Do the provisions of the Income-tax Act (Sections 4A and 4B) regarding the determination of the residence of various assessee, viz., individual, Hindu Undivided family, firm, Association of persons and Company, require any modification? In particular what is your view regarding the retention of the category described as "not ordinarily resident".

We are of the opinion that the provisions of Section 4A and 4B as they stand in the Income-tax Act to-day are out of date. When the Legislation was enacted, India was divided into many parts, in most of which the Indian Income tax did not operate. It was, therefore, possible to escape taxation by crossing the British Indian border, which was not difficult. Provision had, therefore, to be made to define the liability of persons who thus had a dual nationality. Sir James Grigg who piloted the Income tax Bill through the Legislative Assembly, gave two other reasons for those provisions thus: "In the first place, we were trying to cover rather compendiously two extremely difficult classes of cases, firstly the European Official or the trader for that matter in the early years of his stay in India before it had become established that his career is in India, the other is the case of the Indian trader abroad who has an ancestral home in India to visit very irregularly, but possibly enough to become technically resident in every year". The position has altered considerably since then. Out of the three factors mentioned above, the first has become non-existent except for Kashmir; the second has become restricted to a small number in commercial employment. The third however remains. For the latter, no tears need be shed, if the Indian trader who has a dwelling place in India and a patriotic spirit within him, has to pay tax, provided proper relief is paid to him for double taxation, which is being attempted even now.

In the present circumstances in this country, therefore, the elaborate provisions of Section 4A and 4B are now out of date. A simple provision should suffice, such as the one which obtains in Barbados, which says:

- (1) A person who leaves Barbados for occasional residence abroad is chargeable to tax as a resident in Barbados, if his ordinary residence is here.
- (2) A person
 - (a) who is in Barbados for some temporary purpose only and with no intention of establishing his residence there and
 - (b) has not actually resided there for periods totalling six months in the year of assessment is not chargeable as a resident in Barbados.
- (3) A person who satisfies condition (a) but not condition (b) of (2) is chargeable as a resident in Barbados.

The Act does not define ordinary residence; but it is obvious from the negative what the positive position is to be. Under the U. K. Act also the provision in essence is similar, although it is more elaborate because it attempts a greater definiteness without achieving it.

Regarding the provisions of Sections 4A and 4B in the Income Tax Act, as they stand to-day, our observations are as under:

Initially we would point out that the word 'year' occurring in these provisions needs to be properly defined. Acting on the view that all legislation, and in particular fiscal legislation, should as far as practicable be easy to understand and administer, we suggest that the ambiguity which has grown round the meaning of the word 'year' in sections 4A and 4B should be removed. These two new Sections were introduced by the Amendment Act of 1939 and in the course of the debate on the Bill in the old Assembly it was made clear by the spokesmen for Government that the datum year for determining the residential status of an assessee was the official year immediately preceding the year of assessment. This authoritative and, in our view, correct interpretation appears to have been lost sight of and the Department has been interpreting the year as meaning the 'previous year' as defined in Section 2(11) of the Act, i.e., as the period for which the accounts have been made up. This view has also been accepted by the Courts.

We submit that this construction causes inequity. The definition of 'previous year' in Section 2(11) is expressly stated to be applicable "in respect of any separate sources of income profits and gains". The term 'year' in Sections 4A & 4B however stands by

itself, that is, it has not to be interpreted in respect of any source of income profits and gains", and therefore under the General Clauses Act and from the context it merely means the official year preceding the year of assessment.

Apart from the legal view, we submit that the identification of the 'year' with the 'previous year' gives rise to practical difficulties and anomalies. In this country in addition to the calendar and the official year there are various recognised accounting periods which terminate at different times and are of unequal durations, e.g., the Tamil year ending in the middle of April; the Shake year ending in March or April, the Samvat year ending in October or November; and the Shake and the Samvat year are often years of either much less or much more than 365 years since being in the country or maintaining a residence in the country for 182 days or more is a criterion for determining residence, it is obvious that under the Departmental interpretation the assessee who adopts a variable accounting period like the Shake or Samvat year may be in some years at an advantage and in other years at a disadvantage in relation to another assessee who adopts the calendar or the official year and incidentally the period of 182 days fixed at the datum line is itself strongly suggestive that the year in the section was meant to refer to normal official year of 365 days.

Further, an assessee often carries on more than one business each with a different accounting period and each accounting period of different durations, and then it becomes a question for dispute as to which accounting period should be selected for determination of the residential status. Against Section 2(11) (a) permits a change of accounting period once accepted, on certain conditions; and this leaves further room for suspicion and argument.

We suggest that it will conduce to better understanding and avoidance of disputes if it is made clear that "any year" means any official year preceding the year of assessment.

It may perhaps be argued that the proposed interpretation will create disturbance in the assessable quantum of income. This fear is based on the argument that income and status should be determined together on identical facts; but status should determine the taxable income, on which argument the status can be determined independently and the income interpreted for assessment on that finding.

We shall now discuss the anomalies arising out of the present definition in the Act relating to residence of various classes of assessee as dealt with in Section 4A, on the basis that this classification were to remain. We would refer first to Clause (iv) of sub-section (a) of that section. The effect of this new clause which was inserted in 1941 is to save foreigners arriving in this country for the first time for business or employment, from being treated as residents in the year of their arrival and in consequence being charged with tax on their income at the maximum rate. Apart from tourists who are casual visitors passing through this country, we believe foreigners visiting this country, for more or less long periods may be divided into two classes: (1) those arriving under various Government arrangements entered into with foreign governments in connection with various schemes of industrialisation and (2) those arriving on their own account either as employees of existing private organisations in the country or with a view to establish new businesses. Special provisions have been made in regard to the income tax liabilities of the former class of persons; and as regards the latter, we believe that as long as our trade and industry justify the employment of private foreign capital and technical personnel, it will be expedient to remove all conditions likely to cause hardships to individuals. From this point of view, it is a question whether it is necessary to insist on a minimum period of 3 years residence in the country for the individual to qualify for the status of "resident" in the first year. Conditions have changed since 1941 when this new clause was inserted, and it is probably no longer the case that foreigners remain in the country for as long as three years at a stretch. To tax such foreigners on the income earned by them in India at the maximum rate may scare them away or may make it impossible to obtain the services of experts. On the other hand, to retain the present concession on the time basis of an inchoate likelihood, places too great a stress on possibilities and on the individual opinion of the Income tax officer concerned. To obviate these inconveniences and as a compromise which will prevent non-residents getting an advantage which is denied to us

elsewhere, we would suggest that an individual who visits this country, otherwise than for a temporary purpose, should be taxed at the ordinary Finance Act rates with a sur-charge of 25 per cent. on the tax, until he qualifies himself to be called a resident.

Section 4A(c) Companies.—The criteria laid down in clause (c) for determining the residence of companies are new provisions inserted in the Act of 1939 and represent a compromise between representatives of British Business and the Government of India which was intended to secure that British Companies which operated mainly in India but whose central control was situated abroad, should be treated as “resident” in this country. They are undoubtedly wholly artificial and without parallel in any other part of the World. The justification for it lay in only resolving the tug of war between rival claims of business. Actually the effect of the latter part of the clause goes much farther, for while it enables overseas profits to avoid Indian taxation in all circumstances, it permits, overseas losses being deducted from Indian profits in some years. This aspect has been discussed more fully in para. 35 of the Income tax Investigation Commission’s report though the Commission has refrained from suggesting a remedy. We may now reconsider the terms of the definition.

In the first place, as regards the first part of Clause (c) there seems no reason why there should be any differentiation as to the situation of control and management between a company on the one hand and other corporate entities like firms, H. U. Fs. and other Associations on the other. In the case of the latter, a part of such control and management in India suffices to bring them within the resident status and the same test should apply to companies.

If the same test is applied, then it is true that most foreign companies operating in India will become “not resident” but in that event the only disadvantage to a company would be that it would not be entitled to have its foreign losses set off against its Indian profits. This, however, is no more than fair to the Indian Revenue and no foreign company can reasonably ask for more. Even at the time, when this provision was introduced in the Act in 1939, the Hon. Mr. R. H. Parkar had pointed out the effect of introducing the alternative condition for determining the residence of a company. His proposal to replace it by a provision on the lines of the British Act was negative but the reason given for the rejection by the then Finance Member was beside the mark. We would suggest a definition on the lines suggested by the Codification Committee as under:—

“A Company shall be treated as resident in the United Kingdom in a year of charge if it is controlled in the United Kingdom or if it maintains in that year an established place of business in the United Kingdom and any substantial part of the activities of the company whether administered or other is conducted in the United Kingdom” etc.

The word “taxable territories” may be substituted wherever there the words “United Kingdom” occur in the above definition.

The quantum of profits which under the latter part of Clause (c) can be a factor in the determination of residence is obviously wholly irrelevant to the question and this part should disappear. In the result the position of companies as regards residence should be assimilated to that of other aggregates specified in Clause (b) and Clause (c) may be deleted.

It may be objected that this change would result in a loss of revenue to the extent of the tax on the overseas profits of foreign companies assessed as resident under the existing definition. Unfortunately no material is available on the basis of which the amount of such loss can be estimated; any more than the amount of the loss on the existing basis as feared by the Income-tax Commission whereby a company can be alternatively resident and non-resident and in the years of its resident gets its overseas losses if any deducted from its Indian profits. We are, therefore, not in a position to demonstrate the comparative revenue advantage or disadvantage of the existing and the proposed basis. But we surmise that the number of the companies of the particular variety under discussion and therefore the revenue effect, must in any case be small; for we believe that now-a-days most such companies operate in India through subsidiary companies incorporated and controlled in India; and those present no difficulties about their residential status. The question then becomes largely one of principle, *viz.*, whether there is justification in present circumstances for applying different tests of residence to companies and other corporate entities. We submit there is none.

As regards the category of persons described as “not ordinarily resident” the Income Tax Investigation Commission have discussed the question of the retention of this category in paras. 36 and 37 of this Report and have recommended that it should be omitted. We

agree with that recommendation and the reasons given for it.

If this is accepted, it will be necessary to consider how the special cases which that category was designed to meet should be dealt with after the abolition.

First, foreign traders and their employees in the early years of their stay in India. If these persons live and work in the country for not less than 182 days in a year and thereby become resident there seems no reason why they should be treated differently from other resident persons. By placing them in a separate category of “not ordinarily resident”, they were enabled to avoid paying tax on or with reference to their foreign income; and in fact that they were in a more favourable position *vis-a-vis* Indian Revenue than with residents and non-residents. And it may be pointed out incidentally that these several devices in the Act in favour of the foreigner actually benefitted the foreign state treasuries more than the individual foreigners, for if the foreign income had been included and assessed in India, the individual might have had to refund to him a part of tax paid to it. While it is desirable that the introduction of foreign capital and foreign technical personnel should be encouraged by all reasonable means, it cannot be said that deviation from the ordinary taxation law of the country in favour of foreigners is a legitimate form of encouragement. The case is one rather for the simplification and acceleration of the procedure for double taxation relief.

The case of the Indian Nationals trading in foreign countries and maintaining a residence and/or dependents in India and visiting his home in India periodically, deserves more sympathetic consideration. Such traders are a very numerous class operating in such widely scattered areas as the Mediterranean countries, Africa, Ceylon, Burma, South East Asia, China and Japan, and the conditions in which they earn their profits justify their being placed in a special category, and they could continue to receive the same concessional treatment as persons under the existing category of “not ordinarily resident”. But the formula for this purpose should be expressed in terms of different from those of the existing provision in Section 4B(A).

There remains the case of persons who may seek to evade tax by becoming technically resident in some years and non-residents in others. Such persons might include both Indian Nationals and foreigners, and if the present category of ‘not ordinarily resident’ is abolished the temptation to exploit the definition of ‘resident’ in Section 4A to the disadvantage of the Revenue might increase. A suitable formula would have to be devised to prevent such evasions; and in this connection it would seem to be unavoidable to introduce the element of nationality or domicile to the limited extent discussed in the previous para. Thus it was proposed by the Codification Committee that a person should be considered to be principally resident “if he appears in view of all the circumstances of his case to be resident having regard in particular to his domicile, nationality and habits of life”. The expression, ‘Habits of life’ has been construed to include a scheme of dividing one’s time in different countries. This is no doubt a definition that lacks precision, but such indefiniteness is inevitable in the circumstances. Moreover, it will affect mostly the sons of the soil and if they are to pay tax to their own country, it will be less an evil than if they were to escape. The present section 4B may be re-drafted to provide for these special cases.

Question 47.—Does the definition of “income” [Section 2(6c)] require any modification?

We have no suggestions to make that will meet all the requirements of the case. The definition as it now stands in the Act, appears to us, however, as classless, casteless formless. Why only certain inclusions are mentioned and not others is difficult to see. A better way would be to follow the lead of the British Income-tax Codification Committee and make a bigger enumeration which will enable the taxpayer to know what the tax is meant to cover.

Question 48.—Are there any receipts or gains which are not taxed at present, but which in your opinion, should be taxed and vice versa? In particular, what is your view regarding the taxing of capital gains?

It is believed that prize moneys of various kinds such as those offered in Crossword competitions are not now taxed. If it is so, the justification would appear to be that they are the proceeds of gambling or games of chance. We think that there are degrees of chance or unpredictability involved in various pastimes of this kind, which should be recognised. To wager that the last digit in tomorrow’s closing quotation in the cotton market will be an even number is one thing; to expend industry and ingenuity over the solution of a Crossword Puzzle so as to deserve a prize is quite another. There is definitely a greater profit motive in the expenditure

time and energy in the latter than in the former, and on the definition that gains from continuous activity with a view to profit, the prize moneys won in consequence of the labour would and should be taxable to income-tax.

Taxation, it has to be admitted, works as a damper on enterprise, and this, in a country like ours, which is still underdeveloped, is a handicap to progress. Government are committed to certain proposals, which are included in the First Five Year Plan, but the country needs many other industries, which can only be handled, by private enterprise. If the private sector is not encouraged to start or to prospect new undertakings, the well being of the country will suffer or the progress can be only very slow. One way to remove this disinclination to new endeavour is to increase the incentive by tax concession. This needs to be done particularly in respect of those industries which are hazardous but necessary for the well being of the country. Pioneers in these industries require special treatment and special incentive. The best that can be done for them is to offer a tax concession, e.g., exempting the profits for an initial period of years. A beginning has already been made in this direction by giving additional depreciation on new buildings and by exempting for two years the income of property constructed between 1-4-46 and 31-3-52. It should be made a condition precedent to such concession being enjoyed that the Government should recognise the industry as a pioneer industry and deserving of encouragement.

Another effect of India being an underdeveloped country is the need it has of capital investment from foreigners. Such investment can be in industrial undertakings or even in Government and other securities. The latter are more beneficial to the country than the former, they should be attracted by a tax concession as in the U. S. A. In the U. S. A. Code, are incorporated various concessions, partly meant to reduce the tax burden on pure investment income and partly to reciprocate the helpful attitude of other Government. The latter concessions naturally reflect the state of friendliness of the contracting nations. The former concessions, however, are available to all foreign investors and restrict the tax to 30 per cent. irrespective of the weight of the normal tax. Section 231(a)(1) of the Code in which this concessions is embodied, reads :—

"These shall be levied, collected and paid for each taxable year, in lieu of the tax imposed by sections 13 and 14, upon the amount received by every foreign corporation not engaged in trade or business within the United States, from sources within the United States as interest (except interest on deposits with persons carrying on banking business), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits and income, a tax of 30 per cent. of such amount" etc.

Reduction from the general rate is also provided for dividends received by corporations organised or resident in other foreign countries under treaties in effect with such countries". It might attract foreign capital, if some such concession is made by India to foreign investors.

The treatment of capital gains and losses is question that is capable of considerable controversy and argument. On one side is the British view and on the other the U. S. A. view as reflected in their respective codes of income taxation. Under the British method, capital gains and losses are completely ignored. Under the U. S. A. method, they are considered as income for taxation but are given a special treatment. First, there is the distinction made in the U. S. A. between short term gains and long term gains, depending upon the time, the capital assets, the nature of which is defined in the Act itself, are held. The revenue Act of 1924 recognised five time periods with valuation from 30 per cent. for ten years to 100 per cent. for less than one year, for the purpose of taxing the gains. The number of categories was reduced to three in 1938. Then there is the rate of limitation.

The main argument in favour of ignoring capital gains is that they are not income that can be said to be earned regularly and recurrently. They are not an annual gain earned by continuous activity with a view to profit. They are of the nature of the windfalls or even gambles and as other gains of this character, such as from racing, lottery, etc. which are not taxable. It can no doubt be argued, however, against this objection that when capital accretions are realised, they are capable of commanding a greater satisfaction through goods and services even as other income or that they increase the recipient's ability to pay tax. Even this argument however is not always true or correct. Because capital gains occur chiefly in an inflationary market, which also reduces the value of the gains in respect of their capacity to give satisfaction. On the other hand (1) capital gains are the gains of a longer period of years than annual

gains and as they do not recur regularly, to tax them, when they arise impresses a greater burden on a single year than due. (ii) Capital gains have no effect on the standard of living being casual. They usually lead only to a new investment which absorbs the capital gain. (iii) Capital gains fluctuate very widely so much so that they have a tendency to cancel each other. In the ultimate result the effect of the gains to Government Finance is nominal. In fact, the gains are more when the country is prosperous and losses come to deplete the Government Revenue, when it needs to be strengthened. (iv) Capital gains lend themselves to being 'administered or Doctored to meet the taxpayer's opportunities and are more easy to evade, being occasional. (v) There is on the other hand the positive advantage in a country like ours, where the capital transactions are few and far between, that the exemption of capital gains induces investment of capital, and thereby makes the establishment of industries etc. easier.

On the balance of the argument, therefore, we are of opinion that the taxation of capital gains in our country is not necessary, nor is it advisable after the introduction of Estate Duty, which being itself a tax on capital, will cover the capital gains, which will ultimately form part of the assets of a man at his death.

Question 49.—Have you any comments on the present position regarding taxation of profits, which accrue or arise abroad, on their repatriation to India?

That our countrymen, who in spite of hardships, are maintaining the prestige of India in foreign land and are at the same time earning their living in foreign countries, without being a burden on this country, deserves every consideration. But many who thus migrated and made good in their country of labours, find, under the present State of taxation, their hard-earned savings in danger of annihilation by tax, if brought into India. This has been recognised, of late, by Government who have offered some concessions in tax, provided a part of the savings are invested in Government securities. Now that Estate Duty is a part of the structure of taxation in India, same or similar concession is even more necessary and equitable.

The present position as regards profits made by Indian Nationals living and trading in foreign countries who may be technically residents of India is that those profits are taxable in India only to the extent they are remitted or brought into India in each year in which they are so 'resident'. Any profits remitted or brought in the years in which they are not so 'resident' are not taxable. This position arises from the status (not ordinarily 'resident' as defined in Section 4B(a)). Earlier, we have recommended that this status would be abolished and that the profits of Indian Traders abroad who can be said to be resident in India only by reason of the maintenance of a dwelling place and/or dependents in India and occasional visits to India should continue to be taxed only to the extent brought or remitted to India. As regards the balance of such profits and the profits of other Indian Nationals who are technically 'non-resident' we suggest that certain concessions, which the Government of India have announced recently for their repatriation, should be continued and if possible even liberalised, so that on the total, the Indian abroad should not have to pay more than one tax either the tax of the country where the income is earned or of India. Secondly tax certificates should be accepted as sufficient proof of the income earned outside India before repatriation without the necessity to prove the remittance or import as profit taxed in the country of origin of the income. This may no doubt lead the way to evasion by Indians trading this country who might masquerade their own concealed income as of the others; but even that is better than that our countrymen from outside would suffer and in the long run even concealed wealth is better used when circulated than when hidden. We would emphasize here further that morality or the theory that taxation should proceed on the lines of "economic allegiance", our Governments claim to taxation of outside profits is very small, being based only on domicile, (which is no longer a sufficient reason); therefore, Government would be giving up very little that is due to it, even if there is no taxation or small taxation on repatriated profits of Indian Nationals. Those latter, on the other hand, will find patriotism unsound with regrets, if the concessions are offered.

Question 50.—What change, if any, is called for in the definition of "dividend" [Section 2(6A)], e.g., in relation to Bonus shares?

These are obvious inconsistencies in the definition of 'dividend' which call for correction. First under clause (1) a bonus share income to the shareholder only if the issue entails the release of some assets of the company, but under clause (b) a debenture is income even when the accumulated periods are capitalised and no assets of the company are released. There seems no difference in principle between a bonus share issued out of accumulated profits and a debenture issued out of the accumulated profits and the reason for the

distinction is not clear. Secondly under the proviso to clause (d) a distribution out of accumulated profits made to preference shareholders on the liquidation or reduction of capital of a company is not income. The justification for the exemption is not understood. A payment by a company by way of dividend or otherwise out of its profits does not accept its tax liability in any way but it affects the liability of the individual shareholder to whom it is income. The question therefore has to be looked at from the point of view of the shareholder, and it is, what does he get out of the company on his investment in its shares. By whatever name the distribution may be called the fact remains that the company's liability is increased in some cases and its assets are reduced in another case with a corresponding increase in the assets of the shareholder. And after all these extra-ordinary distributions have in fact some out of profits and would have been paid out as dividends in the relevant years had it not been for special exigencies as during the year or for other reasons. The exclusion of bonus shares, as not income profits and gains follows the view of the House of Lords in the U. K. in *C. I. R. Vs. Blott* 8 T. C. 101, but in *Pool Vs. Guardian Investment Trust Co. Ltd.* 87. C. 167, the view was taken that the distribution by an investment company, which held shares in a foreign share, of these shares as an extra dividend, was distribution of assets and as such profits and gains. Similar view was taken in *Briggs Vs. C. I. R.* 17 Tax cases 11 in respect of the distribution of shares in a subsidiary company. In fact also, as bonus shares can be sold for a price, it is not easy to see why their distribution is of capital and not of profits. We think it would not be inequitable to treat all that a shareholder receives out of the accumulated profits of the company as income in his hands. The definitions in Section 2A may be amended accordingly.

In *Sakti Mills* case the High Court has held that a person in whose name a share stands is entitled to treat the dividend on that share as his income irrespective of the fact that at the time the dividend was declared, he had sold the shares, which therefore were the property of another. This creates difficulty for Trusts and Investment companies and share dealers etc. and imposes a loss on investors. The position may be set right. Then again it should be made clear that dividend should be examined for its source and such part of it as appertains to non-taxable sources should be treated as such.

Question 51.—Do the provisions of the Income Tax Act relating to the taxability of non-residents through their business connections in India in respect of income deemed to accrue or arise within the taxable territories (Sections 42 and 43 of the Income-tax Act) affect adversely the interests of persons engaged in foreign trade? If so, what modification would you suggest in these sections?

Generally speaking taxation should be determined on the doctrine of **economic allegiance**. Therefore, in judging whether a method employed for taxing certain profits is equitable and fair, one must try to ascertain first the true economic interest of the person by whom the profits are enjoyed. This has nothing to do with the actual place of residence of the person except in its relation to the considerations that determine economic allegiance. The main points to be considered are (i) the place of origin of wealth; (ii) the *situs* of wealth; (iii) the place of enforcement of the rights to wealth; (iv) the place where the wealth is consumed or residence or domicile. From these arise the following four questions:

- (1) Where is the yield physically or economically produced?
- (2) Where are the final results of the process as a complete production of wealth actually to be found?
- (3) Where can the rights to the handing over of these results be enforced?
- (4) Where is the wealth spent or consumed or otherwise disposed of?

"The most important facts in the situation are (1) and (4), i.e., the origin of wealth and the residence or domicile of the owner who consumes the wealth. Most of the discussion on double taxation has centred round these two points of origin and residence. It is clear, however, that the other two factors may sometimes become of importance, although in most cases they are significant only in reinforcing the claims of either origin or domicile."

League of Nations: Economic and Financial Commission Report on Double Taxation.

On the basis of these factors, the League of Nations Commission evolved four methods of taxing the profits which arise partly within a country and partly outside, which the Commission called:

- (i) the method of deduction for income from abroad;

- (ii) the method of exemption for income going abroad;
- (iii) the method of division of the tax;
- (iv) the method of classification and assignment of sources.

They thought method (ii) the easiest to work, (iii) equitable, but possible in certain circumstances—e.g., in an Empire—only, and preferred method (iv). This means allocation of income for income-tax purposes. This has been attempted in most countries, but no general rule has been evolved that can be made a standard for all.

"The basic principles of the British law and jurisprudence are that a resident enterprise is taxable on whole of its profits derived from the exercise of a trade in the United Kingdom, the principal test of carrying on trade being the conclusion of contracts within that country." This was subject to the provision of General Rule 12, which gives the taxpayer who manufactures goods abroad and sells them in England the option of having his assessment limited to "merchandise profit realised in England." The latter principle was recommended by the Royal Commission on the Income Tax in 1920 to be extended to one who purchases goods in the country, processes them and sells them abroad.

The relative position in other countries has been described by the League of Nations Commission in these words, in 1935:—

"The principle of taxing income attributable to a permanent establishment in Continental European countries implies an apportionment as between the local establishment and a foreign establishment, which together have produced income. The Netherlands East Indies jurisprudence evinces a scientific effort to separate selling profit from purchasing profit, and selling profit from manufacturing profit, in accordance with the relative importance of these activities from an economic viewpoint in the form of a percentage. Austria has crystallised the relative importance of such transactions by fixing ratios inserted in the treaties of Czechoslovakia and Hungary. Spain expresses in percentage form in every case the relative importance of the local establishment in the entire enterprise. In carrying out the constitutional prohibition of double taxation, the Swiss Federal Tribunal has evolved a system of fractional apportionment of total net income in the ratio of productive factors. In the United States, the allocation of the entire income from purchase and sale to the place of sale and the separation of a production, processing or manufacturing profit from a sales profit are written into the Law and Regulations."

As against the methods above shown of taxation of non-resident's profits in other countries, the method followed in India may appear to be harsh. Under the Indian Income tax Act, mere "business connection" is sufficient to attract to the operations of the transactions between a resident and non-resident the unwelcome attentions of the tax-gatherer. The words "business connection" as used in section 42 are capable of a very wide meaning, and have in fact been interpreted very widely by the courts in this country (vide *Remington Typewriter Co. (Bombay) Ltd. vs. C. I. T. Bombay* 5 I. T. C. 177.) Thus it has been held that taxable profits may be deemed to arise to non-residents even if the goods are purchased in this country but are sold outside. Curiously, a resident purchasing in India but selling outside say in Kashmir, would not be taxable on such profits. On the other hand, full profits are interpreted to arise and to be received in India, and are consequently taxable in India, if the sales of goods manufactured or purchased abroad are sold in India. In short, under the Indian law, the whole of the profit can be allocated to British India, whether the establishment or the agency of a non-resident principal sells goods which have been manufactured or purchased abroad or, on the contrary, manufactures and purchases goods in India and sells them abroad. If a non-resident tries to reduce the profits arising in India by inflating the cost of goods imported into this country, the excess charge is deemed to be profits in India and is assessable in the hands of a non-resident's agent. In this, however, India is not alone, because in the Netherlands East Indies, before the formation of Indonesia, the regulations provided for a classified system of taxation on the profits arising or deemed to arise to non-residents, not only on the transactions of sale and purchase, but also on mining and other operations.

Some attempt at allocation of profits between India and foreign countries has been made in enacting section 42(3) and also in Rule 33, which latter provides that where the income of a non-resident is derived both in India and from outside and there are no separate Indian accounts, Indian profits shall be determined on the basis of a proportion of receipts in India to total receipts.

Similar provision is made regarding insurance business by Rule 35. It cannot be denied that in the present infancy of Industrial development in this country, India has to make special concessions to support Indian industries. In view, however, of the position India occupies in the UNO Economic Organization and its participation in other organizations of UNO, it is necessary that as far as possible, the Indian taxation system should follow the principles which have been accepted by other nations of the world as proper and just. As previously stated, the test to be applied to non-residents' profits before taxing them is that of "economic allegiance", and among the factors that go into the composition of the latter we have seen that the two factors that principally deserve to be considered in framing the rules of taxation are (i) the origin of the wealth and (ii) the residence or domicile of the owner who consumes the wealth. We suggest that these tests should be applied before determining the income to be taxed of a non-resident in this country. If this is done, it is inevitable that profits deemed under the Indian tax system to arise to the non-resident on ordinary purchases made in this country will have to be excluded from taxation. Under the present practice, profits are deemed to arise only if a separate establishment or agency is established in India for making purchases for the non-resident, on the ground that purchases require skill. This is a poor argument. The real reason is often that India has monopoly, in respect of the goods. Payment for this special advantage by excise duty is more equitable than by income-tax as in the case of jute cess. Similarly, other profits arising from simple trading with this country, as opposed to trading in this country, have also to be excluded. Thirdly, business connections between a resident and a non-resident may be said to exist only where the non-resident has either an office or an established agency through which to conduct the business.

Looked at in the perspective of the principles that have been settled by international agreement and in the light of the reservations that are necessary to provide for industrialisation in this country, the pattern of taxation trialisation of non-residents' profits might be, we suggest, as under :

		Reason.
Where sales are made in India of goods manufactured or purchased outside.	All profits are received here. Therefore they are taxable.	Origin of wealth is in India.
Where contracts are made outside but goods are delivered here.	Allocation will be made in certain proportion for place of contract and place of delivery, as profits are distributed according to these circumstances.	Origin partly in India partly outside.
Where purchases are made by non-residents in India and where:	Manufacturing or processing profits should be taxed ;	Origin restricted.
(i) goods are processed in this country ;	.....	...
(ii) no processing is done.	Not taxable.	Origin of wealth outside.
Where income is derived in India from fixed assets, e. g. property, loans, etc.	Tax on entire income.	Origin in India.
Where income is derived from services are rendered in India.	Tax on full income.	Origin in India.
Where orders are canvassed here, but contract is finalised outside.	A major proportion of the profits to be allocated to India and the rest outside.	As profits arise at the place of contract, canvassing being the major part of the operations of contract, origin is mostly in India.

It is suggested that this pattern of taxation may not meet with much opposition from the outside world which has business connections with India, as the theory on which the pattern is framed is one which is accepted by the League of Nations as a proper and equitable one. Any attempt to cover larger profits for taxation India might meet with similar reaction against Indian Interests in foreign countries.

There is, one matter which at present works harshly on the Indian trader who has business connections with the outside world. Under the Indian Income-tax Act, it is left to the Income-tax Officer to determine which person should be treated as the agent of a non-resident for the latter's transactions in India, which are distributed among a member of associates, and it has often happened that the choice of the Income-tax Officer falls on a person whom he considers to be the most solvent or perhaps the most convenient for the recovery of the tax; and this attitude has gained further authority by the instructions of the Central Board of Revenue which empower an Income tax Officer to collect taxation due from a non-resident from any one person treated as agent, even in respect of transactions which have not passed through him. This has naturally caused considerable hardship and harassment to the person so selected by the Income-tax Officer haphazardly. No doubt under Section 42(1) such a person is empowered to retain with him funds sufficient to meet the anticipated liability as an agent and beyond these, if properly calculated, he cannot be asked to pay, but this anticipation of liability would naturally, in his case, be limited to the transactions of which he has knowledge, viz., those which are conducted through him. But if he is to be saddled with liability for transactions of which he has no knowledge until the Income tax Officer pounces on him, naturally, either has to pay out of his own pocket or to refuse to pay. If he denies his liability and he has no adequate funds of the non-resident with him, Government will be unable to enforce recovery in view of section 42. Therefore, it may become only a nominal liability. Even so, the tax payer will have to face considerable hardship before he can get out, if at all, of the claims of the Income tax department. We are not aware of any justification, except perhaps expediency, for the method employed by the Income-tax Department in thus trying to fix the responsibility for tax for a part of the business on a person who has no connection with it. In practice also, the method is doubtful of success. Morally, it has no justification. We, therefore, suggest that this procedure of taxing or seeking to recover tax from one of the many agents through whom a non-resident trades in this country should be abolished and agency should be enforced according to the transactions actually effected.

Question 52.—What modification would you suggest in the definition of "agricultural income" [Section 2(1)] to avoid the contingency of the same income being taxed by the Central Government as well as the State Governments, e.g., in respect of income from forests, dividends from agricultural companies, etc.?

Agricultural income had, until recently, been construed to mean income from land as a result of human labour on that land; but recently, in the case of Mulji Sicka & Co. (1946 I. T. R. 92), the High Court has held that actual tilling of the soil is not a sine-qua-non of an agricultural operation. Therefore, we feel that the definition of 'agricultural income' as it occurs in the Income tax Act will need change.

Similarly, up to recently, in taxing the dividends that were distributed by a company which derives its income partly from agricultured and partly from non-agricultural processes, due consideration was made for that part of the dividend income which could be attributed to income from agriculture. The recent decision of a High Court has thrown doubts on the correctness of this procedure, with the result that income from agriculture in the proper sense of the term is also suffering tax in the hands of the shareholders. These anomalies resulting in double taxation require to be corrected, and it is suggested that the definition of 'agricultural income' should be modified so as to preclude such double taxation.

Question 53.—Are you in favour of integrating agricultural income with non-agricultural income for rate purposes? If so, which of the following methods would you advocate :

- Aggregation of agricultural and non-agricultural incomes only under the State Acts ;
- Aggregation of agricultural and non-agricultural incomes only under the Central Act ;
- Aggregation of agricultural and non-agricultural incomes both under the State and the Central Acts ?

Please discuss the administrative, constitutional and other problems that are likely to arise if any of the above alternatives is adopted.

The Income-tax Investigation Commission had referred to this question and had come to the conclusion that, on the consideration of ability to pay, there is great force in the contention that both agricultural and non-agricultural incomes should be aggregated at least for determining the incidence of taxation in the hands of the taxpayers. That was also the view of the Ayers Committee. The Commission was, however, aware of the difficulties that might arise in case any such system is followed in India. In all other countries of the West

there is no system like that of land revenue in this country, where land revenue is considered to be rent rather than a tax. This special position of India has naturally created an obstacle in the way of treating agricultural income as a part of the total income of an assessee for income taxation. As pointed out, however, in our memorandum, in the early stage of income taxation in this country, an aggregation was effected, but such aggregation had proved a failure, partly because of the method or the machinery by which this taxation was administered. India has travelled a long way since then. Even so, the standard of education which is necessary to make a valuation of agricultural income as such in the rural areas is likely to be fraught with difficulties, and in any scheme of aggregation these difficulties will have to be considered, apart from the justice or otherwise of the proposal. A step has been already taken towards such aggregation in the Estate Duty Bill which has recently been enacted by the Legislature. There is every reason to believe that once the inevitability is appreciated by the agriculturist of making a true estimate of his income from agriculture, just as the illiterate trader fell into line with the income taxation procedure, the agriculturist also will, in time to come, fall similarly into line with the necessities of the situation. From that point of view, therefore, we suggest that equity should prevail over expediency and that aggregation should be made for the purposes of determining the rate of taxation.

There are, however, other difficulties which will have also to be surmounted. First, the political implications. It is not without significance that, although six years have passed since the achievement of Independence, the number of States which have imposed a tax on agricultural income is very small. Even Bombay and Madras, the two most fanatical adherents of Prohibition, in spite of the sacrifice of 10 to 20 crores of revenue in the altar of Prohibition, have not sought to recoup that loss by imposing a tax on agricultural income. This may be because in these two States the holdings are small, and the Governments believe that the proceeds of taxation from agricultural income tax might not be considerable. On the other hand, it is also probable that under a system of constituencies based on population and adult franchise, the balance of political power having shifted from urban to rural areas, a tax on agricultural income must directly and intimately touch the pockets of the middle class farmers and land owners, and this possibility is unlikely to commend the taxation of agricultural income to candidates for the suffrage of these rural voters. It seems obvious, therefore, that considerable pressure would have to be applied before many States can agree to this tax being levied. Is the Centre likely to exert that pressure, seeing that it is controlled by a Parliament which is also composed predominantly or representatives of rural areas?

Secondly, Government will have to consider whether it will be fair to equate agricultural income to other incomes. Agriculture has many ups and downs which are beyond the control of the farmers or agriculturists, and a considerable amount of provision or provision against the proverbial rainy day will have to be made before the income can be determined for aggregation. It is true that the present agricultural income-tax does not take these factors into account, but as we are considering what is fair taxation or what is equitable taxation, we think it but necessary that these considerations should be taken into account.

As to who should assume the responsibility for the taxation, we have no hesitation in saying that it will be the Central machinery that should take this aggregation into account for the Central tax. We have no suggestions to make with regard to State Acts in this matter. If, then, it is agreed that the aggregation should be made under a Central Act, the question will arise as to how and through what machinery the agricultural income should be ascertained. Where there is already an agricultural income tax in operation, there may be no difficulty in this matter, but, as stated earlier, in most States agricultural income tax does not operate at present, and it is these States that will create a headache for the tax collector. Moreover, there are many people who are at present exempt from income taxation because, although doing some business, their income from agriculture is large and the non-agricultural income is small. Such people will have to be brought under tax under the aggregation system. In any case, in order to determine whether an agriculturist has got other sources of income to become taxable, enquiry will have to be taken into hand, and this will involve a lot of labour which may in the long run not be very fruitful.

We are bringing these difficulties of the situation to the notice of the Commission, although we are in agreement with the view that theoretically aggregation is possible and is also equitable.

Question 54.—Would you recommend the abolition, by a suitable amendment of the constitution, of the distinction between agricultural and non-agricultural

income and the taxation of both types of income, aggregately under a Central Act?

We think that it will not be possible, nor will it be advisable, to abolish the distinction between agricultural and non-agricultural income in India. The history of income-tax in the West, particularly in England, is associated with the Poor law in the latter country. In fact, in England the local authorities started taxation first for local needs and this taxation was later extended to the State. Starting with local conditions, naturally, the taxation system in England took into account the sources of income in the countryside, which therefore included both agricultural and non-agricultural sources. Secondly, in most countries of the West, what is understood by "agricultural operations" and "income from agriculture" differs considerably from what is understood by the same terms in this country. For instance, in England a farmer devotes more of his time to husbandry, poultry farming, dairying, and so on, and very little of his energies is devoted to the cultivation of land or tilling it unlike the Indian farmer. Meadow lands, which form the greater portion of agricultural holdings in England, are used for the grazing of cattle, horses, etc., and not for the production of cereals, grains, etc. Therefore, the money income that arises from agricultural land in the West is reflected in cattle, poultry, etc., rather than in grains and cereals. The activities of the Western farmer, therefore, are more akin to that of a trader than the activities of the farmer in India. Moreover, there will be constitutional obstacles to face in India. In India land has always been held to be owned by the King in the past and the State at present. Therefore, although the State appropriates a part of the income from land, such income goes to the State as rent of the land rather than as a tax on the income from land, and where this is the political aspect of agricultural income, the Central Legislature will find it very difficult to persuade State Governments to yield a tax on agricultural income to the Central Government. Moreover, the States depend upon agricultural land revenue for the many activities that the constitution of India has made them responsible for, and if land revenue is taken away from the State Governments, very little of revenue will be left in their hands to fulfil this responsibility. We, therefore, are not in favour of abolishing the distinction between agricultural and non-agricultural income.

Question 55.—Is the treatment given to irregular and fluctuating income in the present law satisfactory? In particular, should any changes be introduced—

- (i) to average income over a number of years where receipts are irregular and fluctuating;
- (ii) to spread lump sum receipts over a number of years?

The Income-tax Act recognises the principle that when lump sums are received or an income is received in a year as a result of labours of a number of years in the past, some averaging should be done. The acceptance of this principle is illustrated by the provisions of section 60 sub-section (2) of the Indian Income-tax Act and the recent provision in section 12AA of the same Act. The principle, embodied, in these two provisions has however been made applicable only to incomes from salary and such incomes as royalties and copyright fees for literary and artistic work. We do not see why, having accepted the principle, Government should not extend it to all other classes of income, where the receipts are in lump. The principle that has found acceptance in section 12AA and is expressed in these words: "When the time taken by the author of a literary or artistic work in the making thereof is more than 12 but less than 24 months or more than 24 months evidently takes account of the time taken in the emergence of the income to be taxed. It will be admitted that it is not only the author of a literary work or an artistic work that takes time like this to arrive at the fruition of his labours. A research worker, a miner, a prospector of undeveloped land, experience the same time lag as the author of a literary or artistic work. Thus a scientific research worker might come to a discovery after the labour of a number of years, and this discovery might bring him a lump sum by way of royalty or as the price of an outright sale of his patent. To make a distinction between such worker and an author is making a distinction without a difference. To give a less learned example, the maker of a cinema film suffers from similar handicaps as those experienced by a literary artist, and there is no reason why he should not be allowed the same facilities as the worker in the literary profession. It might perhaps be argued that the initial loss suffered by a film producer would be allowed to be carried forward and adjusted against the future profits. But in actual practice this is not done, for the simple reason that the Indian Income Tax Act considers profits and gains only in the process of carrying out or carrying on a business, and when the business is not being carried on, the loss that occurs is strictly not permissible as a deduction against profits that arise

subsequently. In the alternative, the expenditure is capitalised and is spread over by way of depreciation, but even this procedure is slow in relief, and is not always accepted by the Department. In the circumstances, we suggest that provision should be made in the Indian Income Tax Act by which the initial expenditure incurred in all undertakings resulting in profit which require preliminary survey, labour and expenditure extending over a period of time should be allowed as a deduction against the profits that accrue from that business or undertaking. The allowance may not be given in one year but might be spread over according to the circumstances of each case, which in effect would mean relief of the type that is proposed or suggested by the question.

The two methods referred to in the question, viz., averaging the income over a number of years and spreading lump sum receipts over a number of years, may present difficulties. They, in effect, mean the same thing as we have suggested above, viz., that the expenditure may be adjusted against the income that arises subsequently as a result of the labour of the earlier years.

The suggestion that where receipts are irregular and fluctuating the income should be averaged over a number of years does not commend itself to us, for the reason that such a principle would mean recasting of the system which is followed in India of taxing the income of "the previous year". All income, in fact, is fluctuating and irregular. Therefore, if it is intended to average fluctuating or irregular income, then this provision will have to be extended to all except that arising from fixed assets such as property, loans, etc., as every other kind of income is fluctuating. This would mean, therefore, introducing the system of taking the average of three years or four years, as was done in England with regard to income derived from business, and this, for obvious reasons, is both inconvenient and undesirable, as the experience of England has shown. Even the Tucker Committee recently was luke-warm about the proposal for averaging, and suggested averaging at the surtax level only. With our 15A provisions and gradations of tax at both income tax and super-tax, even the little advantage the scheme might have in the U. K., is not available in India. We, therefore, are not in favour of the proposal to average the income over a number of years where receipts are irregular and fluctuating.

We might, while on this point, refer to the suggestion we had made in our Memorandum of Suggestions submitted to the Commission in May last. We had then said :

"Similarly, workers in hazardous undertakings or in professions which require youthful agility or looks, e.g., chemical workers, mining, air transport undertakings, film acting, etc., have a comparatively short tenure of earning capacity, on which account a part of their actual earnings is in fact advance receipts on account of years when they would be unable to earn. But the State does not make any allowance in taxing the income of the shorter run of the earning capacity and thereby acts harshly against those persons."

While it will be not possible to allocate any particular portion of this income from a hazardous undertaking to advance receipts scientifically, we believe that the principle might be accepted and the persons concerned be allowed a higher deduction on account of insurance than allowed to other persons. By this way, persons in hazardous undertakings might utilise the extra earnings that they receive towards providing themselves against the learner years in future. We would include among the persons to be so benefited the Defence Services whose vocation is as hazardous as that of the others mentioned above.

Question 56.—Do you think the present provisions regarding exemption of charitable and religious trusts need any modification? If so, in what respects?

The question of exemption of religious and charitable trusts has been considered in detail from the legal aspect by the Income-tax Investigation Commission in paragraphs 127, 128, 129, 130 and 131 of their report. We are in entire agreement with the views expressed by the Commission in these paragraphs. We would, however, suggest a few modifications in the views expressed by the Commission.

We suggest that where the benefit from any charity is obtained in India or by the nationals of India, the restriction of the exemption to the limits of the Indian shores should be waived. To make ourselves more clear, what we have in mind is this, that if a trust is formed to help students to pursue their post-graduate studies outside India, the income from such a trust should come under the exemption, because the trust would be benefiting our own country, although the income is enjoyed by the beneficiaries outside the country. Similarly, if a trust is formed outside the country with the object

of helping an institution of a charitable nature like a hospital or a school in India, then the exemption should cover the income that is applied in India to such charitable purpose.

Until recently, income from business carried on by a trust was exempt, if the income was wholly applied to the purpose of the charitable institution and the business was carried on in the course of discharging the primary purpose of the institution, or the work in connection with the business was mainly carried on by the beneficiaries of the institution. By a change introduced in the Act in 1953, income derived from a business carried on behalf of a religious or charitable institution will be included in the total income of that institution for taxation unless the income is applied wholly for the purposes of the institution or the business is carried on in the course of the actual carrying out of the primary purposes of the institution or the work in connection with the business is mainly carried on by the beneficiaries of the institution. It is, arguable that, by the recent change, some of the profits earned by a business might not be covered by the exemption. Thus for instance, if a hospital runs a business in cloth or invests its funds in a business which is manufacturing a product which is lucrative, then the income from this business will not be exempt, as it is not carried on in the course of the actual carrying out of the primary purposes of the institution, not could it be said that the business is mainly carried on by the beneficiaries of the institution. We think that such restriction are not necessary when once the object of the institution and the purpose for which the profits are utilised, are accepted to be of a charitable nature. The exemption is really intended to see that no profits are in fact enjoyed by an individual in the name or under the guise of charity. All that is, therefore, necessary to see is whether the profits go to public charity or to individual hands; and once the authorities are satisfied that the actual benefit goes to charity it seems unnecessary to deny the exemption merely because the activity by which the income is earned is not cognate to the principal objects of the charitable institution. It must be remembered that although India wishes to be a Welfare State, it is still in the process of becoming one. Until, therefore, the goal is reached and the State becomes a full-fledged Welfare State, encouragement must be given to charities which are fulfilling at present the functions which ultimately would fall on the shoulders of the Welfare State.

Question 57.—(i) Should the business profits of co-operative enterprises, which are now exempt, be charged to income-tax and super tax? If so, should co-operative societies be treated as companies or should a lighter levy be imposed? In case the exemption is continued, should it be restricted to certain categories of co-operative enterprises?

(ii) *Do you agree with the view that the income derived by co-operative housing societies by way of rent should not be treated as income from property assessable to income tax? Would you, in this respect, differentiate between tenant co-partnership housing societies and other types of housing societies?*

(iii) *It has been suggested that there are divergent decisions by different Income-tax authorities in respect of assessment of income of co-operative societies from sources other than business. If this is so, please indicate such decisions and the measures you would suggest to secure uniformity in assessment.*

The business profits of co-operative societies are now exempt from income-tax, and co-operative societies are not treated as companies but as associations of persons or individuals. Originally, co-operative societies were formed for pooling the meagre resources of small earners for the purpose of assisting the needy ones from among their fold. Later these resources came to be applied to common purchases of seeds and other necessities by agriculturists and for forming consumers' societies, etc. The principle underlying the exemption of co-operative societies was two-fold. Firstly, as the co-operative societies traded or had business connections with their own members, the trading that was done by the societies was mutual trading, and in mutual trading the well known principle laid down by the House of Lords in the *Styles* case, that a person cannot make profit out of himself, applies. We think that this principle of exempting from taxation profits that arise from mutual trading is salutary and should be continued. It is particularly necessary in this country where the scope for cottage industries is large and Government intend to prospect the possibilities of cottage industries to improve the financial condition of the people. Cottage industries would be greatly helped by co-operative effort, and as they have to compete with large scale producers who have large resources and advantages over the small industrialist, we think that where cottage industries are worked in a co-operative spirit and as a co-operative organisation, the concessions of exemption from tax is due and should be extended or retained.

It should not, however, be construed from this that we support the exemption of profits which are not due to mutual trading. In other words, if a co-operative society trades with non-members, the profits that can be attributed to such trading with others we think, should be brought under tax, as they do not in any way differ, except probably in the quality of the managers, from other business undertakings.

As regards the rate of taxation, while exemption should, we think, apply to profits earned by those societies which do mutual trading or to the profits of mutual trading of co-operative societies, we suggest that the concession of super-tax need not be extended to the profits of co-operative societies. If a co-operative society earns so well as to have income taxable to super-tax, it means that it is not a small venture, but has extensive operations, and, except for the fact that the profits of these societies have to be invested in Government securities, these large undertakings will not be contributing to the exchequer of the Government if their profits are exempted from super-tax. We, therefore, suggest that so far as the profits of co-operative societies are concerned, whether they result from mutual trading or non-mutual trading, they should not be exempt from super-tax; and we further suggest that for the purposes of super-tax the co-operative societies should be treated as companies and be eligible to pay only the corporation tax which is much lower than the ordinary super tax. Therefore, the status of a co-operative Society under these proposals will have to be that of a company and not of an association. This is no hardship if, as proposed by us, the profits of co-operative societies are exempt from income-tax, except in cases where they arise from non-mutual trading.

As regards co-operative housing societies, where the income derived from co-operative housing is mutual, that is, where the properties are let out to members of the co-operative society, we think that such income should be treated as mutual. We would also suggest that tenant co-partnership housing societies be treated differently from ownership housing societies, because the latter class of societies are co-operative only nominally, whereas co-partnership housing is, in spirit and in fact, co-operative.

We cannot quote the divergent decisions by different Income-tax authorities in the matter of assessment of incomes of co-operative societies from sources other than business. If there are any divergent decisions, we think, this divergence can be avoided if it is made clear that the income of co-operative societies derived from mutual trading should be exempt in all cases this will introduce uniformity in the decisions of these authorities. It may be objected to that it might be difficult to distinguish between mutual trading and non-mutual trading, particularly where the societies deal with consumers and sell their products to members as well as non-members. One way of differentiating between members and non-members in such societies would be to insist on a certain rebate being given to members on the business done by them through the Society. This will incidentally show the amount of income that could be attributed to members, and will help the Income-tax authorities to arrive at a proper allocation of taxable and non-taxable profits in the hands of co-operative societies.

Question 58.—Are you in favour of continuing the concessions given to new industrial undertakings under Section 15C of the Income Tax Act? Have initial and extra depreciation allowances made the concessions practically infructuous? If so, what are the directions in which the provisions of this section should be modified?

We are in favour of continuing the concessions given to new undertakings under section 15C of the Indian Income-tax Act. India is in its infancy so far as industrial development is concerned, and although some industries did well during the war period, this was more due to the special conditions of the time which were a period of a sellers' market rather than a buyers' market. Now that industrially developed countries have rehabilitated themselves to a great extent and are entering world trade, aided by their respective Governments and the skill of their workers, India is finding it more and more difficult to make her few new industries hold their own against foreign competition. The export trade of this country is dwindling. In the circumstances, it is but fair and necessary that every encouragement and support should be given to those nascent industries of our country which are likely to prosper in the Indian soil. Certain industries are essential for the growth of this country; certain others are, if they could be maintained, advantageous. Some industries are fully established. Of these three classes of industries, those that are established can be left to shift for themselves; those that are merely advantageous may be supported, but the support can be left to the encouragement of the public to give, as they stand to gain the advantage more than the

State. But in the case of those industries which are necessary either for defence requirements or for the industrial upkeep of the country, special efforts must be made to make them grow and take root in the Indian soil. We would, therefore, suggest that Government should, as the Planning Commission has done, classify industries according to their strategic importance, and give to those which are strategically important or important in the sense of public well being, concessions of a lower rate of taxation or in some other deserving cases, by total exemption from tax for a short period. There is also another aspect from a proposal like this deserves support. India's population growth is greater than the growth of opportunities for employment. From this aspect also it is necessary that new industries should be started and should be nurtured. We therefore think from all these points of view and others, that Government should encourage, by initial allowance for taxation, the growth of industries in this country, particularly industries which are of strategic importance. The concessions given in section 15C are only nominal. They do not touch the problem at all. They only antedate the amount of allowance which is in any case due to the assessee over a number of years. This is hardly a concession. What is required is an exemption of the profits from tax for a small number of years, till such time as is necessary for the industry to prove its ability to stand on its own legs. This will naturally depend on the nature of the industry. Just as in the case of depreciation, allowances are made for classified industries, similarly allowances for this kind of exemption will also have to be made on an approved classification of those industries. In this connection we must point out that at present even the small benefit that is given to industries is restricted to such industries as were started between the years 1948 and 1954. We suggest that if the principle which we have indicated above is accepted, the provision for concession should not be limited to any particular period, but should be available according to the principles laid down.

Question 59.—A suggestion has been made that banking profits of foreign branches of Indian banks should be given concessional treatment for tax purposes in order to encourage the opening of branches abroad. What are your views?

We have all along been in favour of giving concessional treatment for tax purposes, if these concessions are likely to encourage Indian business. In pursuance of this principle, we are in agreement with the view that banking profits of foreign branches of Indian banks should have concessional treatment. If India trade is to expand, branches of Indian undertakings must spread out in the world, and no such spreading out is possible without banking facilities. For such banking facilities, Indian banks will have to keep a large amount of their capital idle as a safeguard under the banking system. On this and other considerations, viz., that additional capital and revenue expenditure will have to be incurred by the banks, we suggest that due concessions should be made in the tax structure.

Question 60.—Should any liberalisation be made in the present limits of exemption from tax of life insurance premia and contributions to provident funds?

The object of allowing life insurance premia and contributions to provident fund as a deduction in arriving at taxable income in the case of persons was to encourage thrift and to enable the persons concerned to provide against a rainy day. It was implicit in this exemption that a person at the end of his career in office is unable to earn, being too old to do so. Therefore, we must provide himself, during the period of his active service, against the leaner years of his later life. In the past, when industrialisation in India was not much advanced, the class of persons to whom the exemption mainly applied was persons in Government service, and these were partly remunerated in their retirement by a pension. Therefore, the concession of one sixth of the salary which was allowable to a person as a contribution for life insurance premium or as contribution to provident fund was only a supplementary addition to the pension. But now that private sector has expanded and this does not provide for pensionary benefits, it appears necessary that the exemption limit for insurance permissible under the Act should be expanded. We arrive at the same conclusion by another way. The standard of living in India is slowly rising, and what was at one time adequate to keep a person in his original standard of life after retirement is no longer adequate. Therefore, the provision that has to be made for providing for the future must be greater than in the past. We would suggest that the exemptions should be granted by way of contributions to provident fund and insurance premia not only against life, but also for policies that are taken out for the education of children, old age disability, or disability for wounds, etc. in the case of the armed forces and other professions or avocations of a dangerous character, and that the limit up to which the concession should be granted should be raised.

The different treatment granted under the Indian Income tax Act to provident funds of Railways and the Imperial Bank of India and the provident funds of other organisations has been a cause of discontent and complaint among the contributors to the private provident funds. We agree that there is a good deal to be said in favour of the view of the contributors to the private provident funds in this regard. The amounts that are contributed by employers to the Provident fund of the Railway servants and the employees of the Imperial Bank are considerable, and the exemption from tax that these funds carry makes the reward to those employers enviously high. In fact they appear at present to be the only exemptions of actual incomes of persons in the Indian tax system. We, therefore, suggest that this distinction may be withdrawn and all provident funds be treated on a like basis.

Question 61.—(i) Do you favour the grant of larger depreciation allowances to assist industry to finance the considerably increased costs of replacement of assets? If so, how and in what form should they be given—

- (a) by larger depreciation allowances on new assets;
- (b) by revaluation of existing assets;
- (c) by treating the excess of replacement cost over original cost as revenue expenditure;
- (d) by any other method?

(ii) What is the justification for assistance from public resources to certain classes of tax payers only by way of covering partially the excess of replacement cost over original cost of old assets?

(iii) In case adequate justification exists for assistance by Government in the form of tax concessions to meet the situation, what safeguards should be prescribed to see that the funds so made available are utilised for the purposes for which they are intended?

The question of depreciation allowances has been dealt with exhaustively by the witnesses before the Tucker Millard Committee, and that Committee has dealt with the problem as presented to them exhaustively in their report to Government in 1951. In our Memorandum we had referred to this question and to this recommendation of the Committee. We may be permitted to quote from that Memorandum:

"It was strenuously represented by responsible bodies before the Taxation of Trading Profits Committee, and the same complaint is being repeated before the Royal Commission on the Taxation of Profits and Income now sitting in England, that the present indigence of taxes is throttling industries. In their evidence before the Commission, representatives of British Chambers of Commerce have stated:

'The most urgent economic tax problem in business profits is the erosion of real capital which is caused by calculating taxable profits without regard to the depreciation in the value of the money. The long term trend is for the value of money to fall; the last 10 years have shown an exceptionally sharp fall, and there are no signs that the pace of decline is likely to slacken in the near future. This fall in value of money makes it necessary to use more money to maintain the same value of stock and to renew the productive equipment in the form of machinery, buildings and other big assets. This extra money must come from self-financing out of trade receipts or by borrowing from creditors or by new investment by the proprietors. . . . Economic considerations point to the need for relieving from taxation the sums annually required to be provided to maintain the productive operational capacity of the business.

"Thus suggestions were made to the Tucker-Millard Committee to meet this difficulty in finance by various persons (a) that the stocks and assets should be allowed to be revalued for depreciation, etc., purposes, (b) that the present written down value of plant and machinery should be allowed to be multiplied by 2 or by their approximate index figure, and (c) that a special allowance dependent on the actual replacement of the plant should be allowed. The Millard Committee ultimately, after considering all the alternative suggestions made to them recommended "that a minimum rate of initial allowance should be prescribed, that any association which represents the particular industry should be entitled to apply for rebate of initial allowance in excess of the minimum, and that the authority responsible for determining these applications should be entitled to take into account both the price level of the plant and machinery in question and also the importance of the particular industry to the national economy".

In arriving at these conclusions and rejecting the other proposals made, the Millard Committee seems to have been influenced by the fact that the concession would benefit old undertakings and not new ones. We think that the Committee have laid too much stress on this aspect of the question. As has been pointed out before the Committee, the question is one of keeping capital invested in an industrial undertaking intact

while using the machinery and plant into which that capital was invested for the purpose of earning the profits of the undertaking. Where there has been an inflationary tendency and the value of the money that was previously invested in a plant is no longer sufficient to replace that plant in case such a contingency arises, the result will naturally be that the capital would have to be found to purchase machinery of the same kind as was purchased in the past. As has been aptly said by the representatives of the British Chambers of Commerce in England, "when the value of money depreciates seriously, it is not sufficient to debit past expenditure in past pounds against receipts in current pounds. To do so penalises business to the extent of the difference between the value of the past pound and the current pound during the time that it takes to turn the asset over". To quote further from the same evidence, "so far as fixed assets are concerned, there are various methods which are available for expressing the change in the value of money. The choice of method would be determined by the efficiency with which the chosen method achieves the purpose of expressing the annual wastage of capital in terms of current pounds. The United Kingdom system differs from the French, Belgian and Italian methods in this respect. In those countries the charge for depreciation for tax purposes follows the books of account, and it was necessary first to revalue the gross value of the assets of the depreciation previously provided in the accounts and to fix a rate to amortise the new net book value over the remaining life of the asset before the figures could be ascertained for tax purposes. Moreover, the work of recalculating the new capital value has to be done each year with each new fall in the value of the currency. The desired correction, however, can be made in conformity with the present system of depreciation allowances by varying the annual allowances to correspond with the degree of inflation which has developed during the year. The annual allowances are the wear and tear allowances. There would also be included such further allowances as may be provided for."

We might invite the attention of the Commission to the extract from the Memorandum submitted by the Association of British Chambers of Commerce to the Royal Commission on the taxation of Profits and Income and published in the minutes of evidence taken before the Commission on 25th July 1952, wherein the recommendations of the Tucker-Millard Committee have been answered effectively by the Association. The extract is too long to be reproduced here, but the points made in that Memorandum have our full sympathy, and we suggest that the action proposed by them should be duly considered by the Commission and effect given thereto.

One aspect that differentiates Indian industries from those in the West is that, while in the West the machinery is being rapidly replaced and improvements are being incorporated from time to time, India has had to depend more often on discards, and owing to the low profits that were realised before the war, replacement of old machinery was very rare or was only sparingly resorted to. The result has been that in most old established industries the machinery that is in use is outmoded and overworked. The replacement of that machinery has therefore become a very urgent factor. While the outside world which can supply the replacements is itself passing through an inflationary period it has raised the costs of replacement for the Indian Industries. This is a very serious problem, and tinkering with it will only end in disaster to the Industries. It is therefore absolutely necessary that the question of adequate depreciation allowances should be considered immediately. We would suggest, in addition to the proposals made (1) that Government should allow deductions from profits which are ploughed back into the industry for the purposes of replacement of old machinery and parts; (2) that excess sale proceeds which under the present act are taxable under section 10(2) (vii) should not be considered as taxable if the money is reintroduced into the business for purchasing fresh machinery and plants, and (3) that depreciation allowances should be made to vary with the rise in the index price of the machinery to be replaced. Our answer, therefore, in regard to the choice out of the four methods suggested by the Commission is that we agree to (a). With regard to (b), although it is an attractive proposition, there are great difficulties in implementing it, both from the point of view of valuation and of accounting for additional valuation. As for (c), we agree that this is also an attractive proposal, but the difficulty is likely to be that the difference between the replacement cost and the original cost might be so heavy as not to be covered by the profits of the industry in the year in which the replacement is made, and unless the difference is carried forward as a depreciation allowance, the proposal will be of very little value.

The questions of the Commission suggest that public resources would be taken away from one class of taxpayers to benefit another class if the above proposals are

accepted. It is not understood how the proposal leads to this conclusion. The allowances are to be made as expenditure due for arriving at the true income of the assessee. The true income is arrived at if the capital invested is not reduced, and capital here means real capital, i.e., the owner of the funds and retains the same ability as before to replace his plant or machinery, without touching his capital. In other words, the depreciation allowed or allowable should be sufficient to replace the capital asset without the proprietor having to dip into his pocket. If it is considered that depreciation allowances on the old written down value are sufficient for this purpose, then the question of giving additional depreciation would not arise at all. But if the principle is accepted that the role of depreciation is to keep the original financial ability of the owner of the capital asset intact in spite of the present inflationary trend, then it follows that depreciation on the old valuation is inadequate and insufficient. Therefore, what is to be allowed would be a higher depreciation, more in conformity with the present values, and if such an allowance is made, it will be only what is due to the industry or to the industrialist in order that his true income may be assessed to income-tax. Therefore there will be no extra benefit allowed to any one class and no diversion of public resources to benefit a certain class of taxpayers in the proposals that we have made, but only a legitimate attempt at justice.

The safeguard that we would prescribe in order to see that the funds so made available to the Industry are utilised for the purposes for which they are intended is that the income-tax authorities should be satisfied that those funds are not utilised for any other purpose. This can be done by maintaining a separate account of the allowances made, which will also show the way in which that allowance is expended or utilised.

Question 62.—Are any changes called for in the classification of assets for purposes of depreciation of assets, rates of depreciation and methods of computing the allowances?

We have no suggestions to make for the reclassification of assets for purposes of depreciation. The rates of depreciation, we think, should depend upon the time taken by each depreciable asset to fully depreciate. As regards the method of computing the allowances, the written down value does not fully cover the entire 100 per cent., and we therefore think that the old method of allowing full depreciation should be re-introduced. As has been rightly said, the justification for a depreciation allowance is that a trader should be allowed to replace any capital used up in the year's trading before he is assessed for profits. The only reasonable principle is that capital should not mean one thing at one time and for the same trade a different thing at another.

As a further safeguard to see that the rates of depreciation are adequate, and that full depreciation is allowed to the industries concerned, we would suggest that expert bodies like the Institute of Chartered Accountants of India and the Manufacturers' Association should be consulted from time to time for fixing the rates and the manner in which those rates are to be applied.

Question 63.—Should any tax concessions be given to encourage development of mineral resources? If so, what form should they take? In particular, should depletion allowance on wasting assets be allowed? How should it be computed for different kinds of assets you have in view?

Regarding depletion of wasting assets such as mineral resources and the development of such resources, we think that special encouragement should be given and is due to the prospecting and exploitation of the mineral resources of the country. At present the prospecting expenses are treated very differently by different authorities. Thus if a company were to prospect for mineral resources in a particular area and it is found at the end of the prospecting that that particular effort is not fruitful, then the prospecting expenses are a dead loss to the company. There are no means by which such losses can be claimed by the company under the Income-tax Act. Even when other efforts are made which prove fruitful, the original expenses which had gone to waste are often not allowed, because they were not incidental to the particular endeavour that was successful. We think that such a treatment of prospecting expenses is likely to discharge prospectors in this country, and in considering the allowance or otherwise of expenses, the business of prospecting should be considered as one, and the expenditure incurred in the course of such business has not to be judged only so far as it concerns the successful part, but as a whole so long as prospecting is done. Therefore, if a prospector for iron fails at one place but succeeds at another, the total expenditure to be considered should include the expenditure not only at the successful place, but at both places. It is likely to be urged that prospecting is a capital expenditure, intended to create an asset of a capital nature, and it is possible that the Department might contest the claim

of expenditure on that account. On the other hands, if the expenditure is considered as of a capital nature and as no asset is created, by that expenditure, the Department might object to the expenditure being spread even by way of depreciation. We, therefore, think that concessions should be given that will take into account expenditure, even where expenditure is capitalised, which will enable proper recoupment to be made.

Regarding depletion allowance, under the English system, it would include capital expenditure incurred by a person in connection with the working of a mine, oil well or other source of deposit of a waste nature is allowed for the purpose of searching for or discovering and testing deposits or winning access thereto, or expenditure incurred on any works which are likely to be of little or no value when the source is no longer worked for, or where the source is worked under a foreign concession which is likely to become valueless when the concession comes to an end to the person working the source immediately before the concession comes to an end, but no expenditure is allowed for acquisition of the site of the source, of rights in the deposits, for expenditure on machinery and plant, expenditure on buildings and structures, etc. Certain initial allowances were permitted up to 1951-52. There are, however, other suggestions of a more practical character which we think will be more effective. Thus one method is to grant the deduction of a percentage on the cost of the wasting asset until the full 100 per cent. of the cost has been met. In the U. S. A. another method is more widely used, and that is to grant the allowance as a fixed percentage of the gross extractions each year, regardless of the cost of original acquisition. Thus the Federal Law allows a deduction of 27½ per cent. of gross extractions of oil each year as long as anything is extracted. We suggest that the latter method will be more beneficial both to Government and to the persons concerned, and we recommend it.

Question 64.—In what form would you provide for personal and family allowances—

- (i) exempting the first slice of income from tax; or
- (ii) providing specific allowances for family and dependents?

In the case of (i), do you consider that the first slice—Rs. 1-1,500—should be revised? In the case of (ii), what treatment would you give to the Hindu undivided family?

In our Memorandum we have dealt at length with the proposal that family allowances should be allowed under the English system, and we have sought justification for our proposal in the doctrine of "ability to pay". We have also suggested there, following Mr. Harrod who gave his evidence before the Royal Commission on Taxation of Profits and Income on the 27th of June 1952, that special allowance may be made for expert work.

There is very little difference essentially between exempting the first slice of income or providing specific personal allowances. It is only a question of what the first slice should be and what it should stand for. If the first slice is to represent the minimum that is necessary for a person to live in comfort as a single individual or a bachelor, then it becomes a personal allowance for a bachelor, if looked at from the point of view of expenditure, or it becomes the first slice of income to be exempt from tax, if considered comprehensively. In either case, therefore, the consideration appears to us to be the same, viz., what would be the expenditure that a person, unhampered by dependents and not weighed down by the responsibilities of family or other expenditure, would have to incur. This again, depends on the cost of living index, and we should think that the best course would be to provide specific allowances for family and dependents, taking as the starting point the minimum cost of living for a single individual who has no responsibilities such as the maintenance of dependents. We think that in such a case the first slice or the minimum should not be less than Rs. 2,400, that is Rs. 200 a month. Further allowances should be made for the wife and children and relief of other dependents. In order that the claims for allowances may not be excessive, we would also prescribe a maximum up to which a claim can be made for personal allowances. Taking Rs. 2,500 for a single individual, we think that the maximum that can be allowed to a family should be Rs. 9,000 comparing Rs. 2,000 which was the taxable income prior to 1939, and raising it by the increase in cost of living index since then, this limit of Rs. 9,000 will be found to be not too excessive. In the case of a Hindu Undivided family, it is difficult in these days to lay down a specific rule, for the simple reason that although a family may be undivided, it does not mean that all members of the family live together and at one place. It only means that in the case of a joint Hindu family the initial responsibility or responsibility of the

lowest slab is of greater value. This lower limit will have to be fixed with reference to the number of coparceners in the case of a Hindu Undivided family, and the maximum might be placed at Rs. 12,000.

Question 65.—Should the present law regarding admissible expenses [Section 19(2)] be altered? If so, please indicate with reasons, the items of expenses (i) which are not now admissible but, in your view, should be admissible and (ii) which are now admissible but, in your view, should not be admissible.

The law in respect of the allowable expenditure is based on the English Act, and enacts that only such expenses should be allowed as are laid out or expended wholly and exclusively for the purpose of the taxable business, profession or vocation. Under the provision as it stands at present, the expenditure to be deductible must first jump the first hurdle, namely, that it should not be considered to be expenditure of a capital nature.

The expression "expenditure of a capital nature" has been a bone of contention before many Courts, and even now no finality has been reached in regard to the expenditure that can be called definitely of a non-capital nature. If this hurdle is passed, the next test which the expenditure has to submit to is whether it is for the purposes of the business. Now "purposes of the business" is not the same thing as "in the course of a business", and therefore this difference has raised a good deal of controversy. The Courts have often subjected allowable expenditure to the test as to whether the expenditure is necessary to be incurred in order to obtain or to arrive at the assessable profits that emerge out of a transaction. Thus, for instance, if a person is fined for a breach of the Control Regulations, it has been held that the fine paid or the amount that is spent on legal expenses is not an expenditure for the purpose of the business, and therefore is not allowable. Such an argument baffles the layman. It cannot be denied that the Control Regulations can be broken only in transactions of a business nature or transactions which pertain to a business, and the proprietor of the business, except as such proprietor, has no concern with these transactions. Therefore, to say that the fine is not for the purpose of business, although it is incidental to the business is too harsh a construction to be placed on the admissibility of expenditure. We would, therefore, suggest that instead of the words "for the purpose of a business" the words "in the course of a business and incidental thereto" should be inserted.

Another aspect of the same problem is that expenditure is often disallowed by the Income-tax Officer as excessive. Some Courts have taken the view, which we think is right, that when an undertaking incurs an expenditure, all that the Income tax authorities have to see is whether that expenditure is for the purposes of the business or incidental thereto. Once this test is satisfied, about the quantum of that expenditure the matter should rest more properly with the assessee than with the Department. As the Chief Justice of one High Court has said, the Department cannot dictate to a taxpayer as to how he should conduct his business. Therefore, if an expenditure is incurred, provided the expenditure is for the purposes of the business, the Income-tax authorities should not be allowed to interfere with regard to the quantum to be allowed. It is no doubt true that collusively some excessive expenditure might be claimed by an assessee. In that case, it will rest on the Department to prove that such collusion exists, and if such collusion can be proved, then there will be a ground for the I. T. authorities to contend that the expenditure is not entirely for the purposes of the business. With this restriction, we think that all expenditure that is incurred for the purpose of a business or in connection therewith should be admissible. We do not propose to refer to other points of disagreement between the assessee and the I. T. authorities in the matter of expenditure, such as the payment of secret commission and so on. The approach of the Dept. can be defended on the ground that secret commissions are by their very nature not provable, and therefore, if no restriction is placed on the allowance to be made for such expenditure, a large number of spurious claims are likely to be made. There is one type of expenditure, which is disallowed by the Dept. as capital expenditure, which, if allowed, is likely to help industrial development in a country like ours, where such development is badly required. We suggest that if any profits are placed in reserve by a business for being ploughed back into the business for its development when the actual expenditure is incurred it should be allowed. The purpose of the use is capable of being easily checked and therefore there would be no difficulty in implementing the suggestion. When implemented, it is expected that the result will amply repay the sacrifice in tax by the Government.

Question 66.—(a) Are you in favour of combining income-tax and super tax into a consolidated levy, (b) What are the merits or demerits of such a step

from the point of view of (i) assessee, (ii) administration? (c) Are you satisfied with the degree of progression in the present rate structure (both income-tax and super tax) especially in regard to its economic effects? (d) In case you consider a change is necessary, what alternative rate structure would you recommend? (e) Should the rate of surcharge levied under Article 271 of the Constitution also be graduated?

(a) and (b) A number of arguments can be stated in favour of combining income-tax and super-tax into a consolidated levy. Thereby the taxpayer would know how much he has to pay more easily; and the complications which arise on account of some incomes being assessable to income-tax but not to super-tax and which create a lot of confusion in ascertaining his total liability to the taxpayer, being automatically removed, there will be greater simplicity in the tax structure. The gradation in the tax will be more easy to arrange under a single rate system than under the dual system as it exists at present. On the other hand, although there are these arguments in favour of simplification which assist the assessee in the proper understanding of the tax structure, from the point of view of the administration there are, we think, more potent arguments in favour of the present system. It is a rule of taxation that the tax system should be such that it can be adjusted to the needs of the Government, which often fluctuate. The rate structure must therefore be such as can easily lend itself to change according to the needs of the Government from year to year. A single rate is not so pliable, nor does it tend itself to being dressed up, so as to conceal the full extent of increases in tax. Super-tax has again this advantage, as a separate tax, that it can be made selective as regards persons and progressive as regards rate without touching the common man, which is an advantage in a country like India where persons in the lower income brackets are predominantly more than in the higher income brackets. From a recent review by the Central Board of Revenue of the number of assessee—which unfortunately is the only statistical **communiqué** of Government on which we can draw in the absence of the published accounts of the Central Board of Revenue—it appears that the number of persons paying tax on incomes of over Rs. 1 lakh is almost negligible. According to the figures published by Government, of 6,47,376 persons who were found assessable, there were only 4,737 assessee with incomes over Rs. 1 lakh in 1951-52, and they accounted for 63.5 per cent. of the total gross demand for the year. Assessee with incomes between Rs. 25,000 and Rs. 1 lakh made up 21.5 per cent. of the total demand, and these with incomes between Rs. 10,000 and Rs. 25,000 about 9.5 per cent. of the demand. By far the larger number of persons assessed fell in the category of incomes below Rs. 10,000 and accounted for only 5.5 per cent. of the demand. A large percentage of the tax demand, viz., 63.5 per cent., is accounted for mostly by super-tax payers. Therefore, from the point of view of the facility with which different classes can be treated separately according to needs, the distinction of the rates as income-tax and super-tax appears to us to be desirable, and we think that this distinction should remain.

(c) and (d) The degree of progression in the existing rate structure appears to us very unsatisfactory. The present progression was devised during the War, but although the War has been over nearly 8 years now, the structure practically remains the same, as before, except for a small difference here and there. So long as the war profits lingered in the hands of some of those who earned them and business conditions remained outwardly at least satisfactory, aided by these war profits, the rates of taxation did not weigh too heavily on the persons concerned, but as the war days are receding into the background and also the results of it, the lower surface is becoming more and more visible, and against this background the rate structure appeared to be too harsh and grinds industrial profits to pulp. Every tax structure has to take into account the peculiar circumstances of the country for which it is framed. In a Welfare State where medical, educational, old age, sickness and similar benefits are provided for by the State, the tax not merely makes a contribution to the running of the administration, but also a contribution for many personal needs of the ordinary citizen. In India, the tax that is being collected by Government goes mainly to support the administration, and therefore, with the meagre amount that is left in the hands of the taxpayer he has to fend for himself to meet the urgent needs of personal living, maintenance and well being. Under the Five-Year-Plan, Government expect the industries to find their own capital. In effect, the tax that Government seeks to claim from the Indian citizen does not come back to him in any shape or form, except perhaps good administration and the defence of the country. It is, therefore, essential that the tax structure should be such in this country as will leave to the common man enough to live in comfort, and to the industry sufficient

capital to reimburse itself to expand, to equip itself against outside competition and to offer to the poorer classes consumers' goods at a cost within their means. These considerations must lead to only one conclusion, that the tax should not be heavy, until at least Government undertake larger responsibilities as a Welfare State and take up the nursing of industries that are necessary for the advance and the growth of the country. We have shown above from the **communiqué** of the Finance Ministry that the number of persons earning large incomes in this country is surprisingly small. In 1951-52 there were 6,47,376 people who paid tax from all sources, of whom 5,10,412 earned an income below Rs. 10,000. Again, out of the total number of 6,47,376 who paid tax, 5,47,539 were individuals, 65,750 were Hindu undivided families, 23,326 were unregistered firms and other associations and individuals, and 10,761 were companies and other concerns assessable at the Company rate. According to the above classes, the income assessed in the hands of these persons was individuals, 475.5 crores; Hindu undivided families, 80.3 crores; unregistered firms, 27.2 crores; Companies and other concerns, 199.9 crores; total 782.9 crores, and the gross demand against these was 195.8 crores, which gives the average tax rate as about 25 per cent. on the total income assessed. 25 per cent. is a high average rate for income-tax. It is high time that the rate structure should be modified, and if Government cannot do without keeping the rates at the present high level, the only alternative is that they should cut down their expenditure. The Five-Year Plan can be made into a Ten-Year-Plan, if necessary, but no five-year plan which is built on the misery or hardship of our country is worth having. The administrative machinery must be cut down if the common man is to live. The essential need is that the Indian should live in comfort and should have the means to meet his requirements. This can only be done if a smaller slice is taken away from his income than is done at present.

A Committee on Post-War Tax Policy investigated the problem of the tax structure in the U. S. A. and they have published a tax programme for a solvent America. We quote the following table suggested by them for personal income-tax rates, in extenso.

Taxable Income Brackets.	Alternative rate Schedule (In per cent)		
	High	Middle	Low
0 — 2,000	20	18	15
2,000 — 4,000	22	20	17
4,000 — 6,000	24	22	19
6,000 — 8,000	27	25	22
8,000 — 10,000	30	28	25
10,000 — 12,000	33	31	28
12,000 — 16,000	36	34	31
16,000 — 20,000	39	37	34
20,000 — 25,000	42	40	37
25,000 — 50,000	45	43	40
50,000 — 75,000	48	46	43
75,000 — 100,000	51	49	46
100,000 — 200,000	54	52	49
200,000 — 300,000	57	55	52
300,000 — 400,000	60	58	55
400,000 — 500,000	63	61	58
500,000 — 750,000	66	64	61
750,000 — 1,000,000	69	67	64
Over 1,000,000			

If these rates are fair for a country like America, where the Government is able to provide many needs for its citizens, it goes without saying that for a poor country, like ours the rates should be lower, at least in the earlier slabs.

We would point out in connection with the above table that the rate scales combine normal tax and super-tax in a single schedule. We quote the following from the proposers of this programme :

"There are no scientific rules for determining the relative merits of a proportionately and moderately progressive or a steeply progressive scale of individual sur-tax rates. We believe that while keeping in mind considerations of equity and the needs of the Treasury, it is of paramount importance that such rates are not set so high as to constitute a deterrent to investment. We agree with the view that there is a point well below the level of confiscation at which the effect of such a tax on the venture spirit, and hence on the national economy is virtually the same as if it were 100 per cent. Certainly a prospect of having to turn over three-fourths of the profits of a business or of additional professional income is calculated to have a dampening effect on the spirit of enterprise.

"Not only do steeply progressive surtax rates stifle enterprise, but it is a truism that the more punitive they become, the less productive they are, even from the short term viewpoint. We have abundant evidence that the surtax rates above, say 50 per cent., are but negligible value to the Treasury".

Another alteration in the present tax system we would suggest is that income on which Corporations are taxed should not be taxed a second time in the hands of individuals who receive the dividend, except to the extent that the individual may be subjected by including the dividend, to higher rates of tax than are paid by the Corporation.

One of the complaints against the Income-tax structure is that under the present system of taxation, refunds become necessary to many people. The individual rate of taxation for a large class of persons being low and the rate of taxation of the income in the hands of the Corporations being high, applications for refund are many. In this connection, a suggestion has been made by the Committee in the U. S. A., to which we have referred above. They say: "The stockholder would include his individual income in his taxable income. After computing the tax, he would take a credit on account of the tax paid by the Corporation with respect to his dividends. This credit would be calculated by multiplying his dividends by the basic or lowest bracket rate of the individual income-tax. In order to avoid refunds it should be provided that the credit should in no case be greater than the total tax due. This plan admittedly does not achieve a perfect adjustment between the Corporation and individual income-taxes. A method could be devised which would produce such an adjustment, but only at an uneconomic cost and complexity. The procedure suggested achieves reasonable equity combined with simplicity". We bring this suggestion to the notice of the Commission for its consideration.

Another complexity that has arisen—and it is partly responsible for the labour that an Income-tax Officer has to put in calculating the tax in individual cases—is the present method of treating dividend income. In the past, dividend income was not taxed again, but it was considered for rate purposes, and only if refund was claimed and the claim was supported by vouchers, was the tax collected on the dividends adjusted against the tax due. Under the present system, dividend income is treated as every other income which means that the taxpayer has necessarily to produce the vouchers so as to claim refund, and the work thrown on the Income-Tax Officer is correspondingly more, even in spite of the fact that a good many of the persons concerned would not have cared to claim the refund but for the double taxation that would otherwise result. We suggest a reversion to the old system as a measure of economy and simplification of working out net taxes.

(e) Sur charges are by their very nature a measure to be invoked in cases of emergency. We are therefore not in favour of having surcharges in normal times, but if a surcharge is to be levied at all, then we agree that it should be graduated even as the other rates of income taxation.

While on this point, we might recall to the notice of the Commission a proposal, which created a controversy some years ago, viz., the decimal system of coinage. If the coinage were divided decimally, the taxes would have automatically been shaped on a decimal or a percentage basis. As the proposal for coinage has been shelved, with little hope of revival, we suggest that the rates of tax should instead of being stated in pises, be revised on a percentage basis. This will save clerical labour and make a considerable difference in the cost of collection, besides making it easier for assesses also to calculate their liability.

Question 67.—Have you any change to suggest in the exemption limit for individuals (Rs. 4,200) and for Hindu undivided families (Rs. 8,400)?

We have already, in answering Question No. 64 given an indication of what the exemption limit for individuals and Hindu undivided families should be. We have said

there that for bachelors it should be Rs. 2,500, for families up to a maximum of Rs. 9,000, and for Hindu undivided families a maximum of Rs. 12,000, the graduation being made according to the number of individuals concerned.

Question 68.—(a) Are you in favour of a distinction being made between earned and unearned incomes? What is the economic justification for such a distinction? (b) Is the present definition of "earned income" in Section 2 (6A, A) of the Income-tax Act adequate in this respect or would you suggest any modification? (c) Should the quantum of relief now afforded be extended or reduced? If so, to what extent?

(a) We are in favour of the distinction being retained between earned and unearned incomes. The justification for such a distinction lies partly in the fact that in the case of unearned income, the person concerned is less bothered about the future, as the capital inherited from the past, lightens his responsibility. In the case of earned income, the responsibility lies on the person concerned not only to provide for his own future but also for that of his dependants. Therefore, from the economic point of view, it is but necessary that a person earning his own income should be allowed to collect more savings than a person whose income is wholly unearned.

(b) We have no alternation to suggest in respect of earned income definition.

(c) The quantum of relief now afforded is on the right lines. It should not be reduced; it might be extended, if at all, add the extension will depend upon the cost of living index and the rate of return on investment.

Question 69.—Have you any changes to suggest regarding the principles followed in valuing stocks of a business for assessment purposes?

The question of valuation of stocks was considered by the Millard-Tucker Committee, and they have come to the conclusion that the present system of valuation at cost or market, whichever is lower, should continue. The United States are, however, not quite so definite in this matter, although in the final analysis, they also subscribe to virtually the same rule. Their Internal Revenue Code contains many rules and regulations defining the method in which the stock should be valued, but the main principle that underlies that system is the same as that in the British system, viz., that "the taxpayer's method of inventory valuation must clearly reflect income and must conform to the best accounting practice in his trade or business". Regulation 111 of the Code says "In order clearly to reflect income the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventory or basis of valuation, so long as the method or basis is used substantially in accordance with the regulations". According to Regulation 111 of the U. S. Code further, the basis of valuation most commonly used by business concerns and which meets the requirements of the case, are (a) cost and (b) cost or market, whichever is lower. This raises the question of what is cost and what is market. What cost means has been defined in Regulation 111 of the Revenue Code of the U. S. A. and we would invite the attention of the Commission to this Regulation. That Regulation lays down also a very salutary principle on a much contested question. It says "A taxpayer engaged in mining or manufacture who by a single process or uniform series of processes derives a product of two or more kinds, sizes or grades the unit cost of which is substantially alike and who in conformity to a recognised trade practice allocates an amount of cost to each kind, size or grade of product which in the aggregate will absorb the total cost of production may, with the consent of the Commissioner, use such allocated cost as a basis for pricing inventories, provided such allocation bears a reasonable relation to the respective selling values of the different kinds, sizes or grades of product". We support this method and suggest that the Commission might recommend it to Government.

Market is also defined in the same regulation. For the manufacturer's products the total of material, labour and overhead at current prices represents the manufacturer's cost to produce an inventory item and is regarded as market.

Where there are many market fluctuations in respect of a commodity necessitating the dealers to hedge against spot or cash purchases, such open hedges as well as corresponding inventory quantities are under the U. S. A. system taken into account at market value on the inventory commodity. Thus the relationship between the commodity purchased and the offsetting hedge continues unchanged. We recommend the above quoted definitions and this procedure for being followed in India.

The U. S. A. has given to the world two systems of inventorying. One is known as the "fifo" system, which means last in first out, and the other is "fifo", first in

first out. These systems are too complicated for Indian traders, and we would not recommend their use in this country.

Question 70.—Do you consider that any change is called for in the method of assessment of the Hindu undivided family? If so, in what respects.

We do not consider that any change is necessary in the method of assessment of Hindu undivided families at this stage. The Indian tax system having accepted the principle that an unregistered firm can be assessed separately, there is no reason why a Hindu undivided family should be denied its rights to be assessed jointly. Secondly, as the real income only is to be taxed, and the participants in that income in the case of a Hindu undivided family cannot specifically lay claim to any particular portion of that income or enjoy that income, a joint Hindu family is by its very nature an association of individuals, and, as an association is a recognised taxable unit under the Indian Income-Tax Act, we think that the Hindu undivided family should also continue to be so. In one respect the Hindu undivided family, however, enjoys a special benefit, viz., that under section 14 of the Act, the share of a coparcener from that income cannot be added to his income. This is unlike an unregistered firm or an association of individuals. This, we think, is as it ought to be because, while in the case of an unregistered firm or an association of individuals, the participants or partners are in a position to claim their share and to enjoy it, in the case of a Hindu undivided family such a right of enjoyment is nominal and not real. Therefore we think that the present system should continue.

Question 71.—Should exemption from income-tax be allowed in respect of voluntary surrender by managing agents of the whole or a part of Managing Agency commission? What safeguards should be laid down against misuse of such a provision?

As a rule, managing agents surrender the whole or a part of the managing agency commission only when the managed companies cannot bear such an expenditure. The result of it is that what would have come to the managing agents as their income remains the income of the Company and is taxed in the hands of the Company. The tax effect, if any, of such a self-denial by the managing agent is on the whole nominal. Where the managing agency is itself a company, what is surrendered by the managing agents as managing agency commission is taxed at the Company rates in the hands of the managed Company, and as, if it had been received by the managing agents, it would also have been taxed at the rate, there is no difference in taxation at all. If, on the other hand, the managing agency is in the hands of a firm, then it is more than possible that the income would be divided, and the effective rate of taxation would be less or, at least, greater than the tax that would have been recoverable from the Company. Therefore the tax effect of such voluntary surrender by a managing agent of the agency commission receivable by him is negligible or nil. From the moral standpoint, the fact that the managing agents have surrendered their rights to income raises their prestige in the eyes of the shareholders, which is an advantage for the industry. From the point of view of the shareholder also, the managing agency commission that is surrendered may come to him by way of dividend at least partly, but if it was not surrendered it was not likely to come to him at all. Therefore we think that there is no case for taxing the voluntary surrender of managing agency commission in the hands of the Managing Agents legally, because they are not in receipt of that income, morally or ethically, and from its effect on the industry.

The question suggests that such a power can be misused by the Managing Agency to suit their taxation. If, for instance, a Managing Company has suffered a loss, then the surrender of managing agency commission would not result in any tax being realised in the case of the Company, while if the commission was received, it would be taxable in the hands of the Agents. This again is taking a dwarfed view of the transaction. To the extent that the commission is surrendered, the depreciation allowance is carried forward less. Therefore, in the long run the effect of taxation is the same. Income, under any system of taxation, is what is actually received or receivable, but where a right is surrendered the income is neither received nor is it receivable. Therefore, we think that, considered from all points of view, it will be incorrect to deny exemption from income-tax in respect of voluntary surrender by managing agents of the whole or part of the managing agency commission. We have already said that the chances of misuse are remote. Managing Agents are also human beings, and are not likely to surrender their rights, particularly when shareholders are becoming more and more alive to their rights and responsibilities.

Question 72.—On what basis would you suggest that double income-tax avoidance agreements should be concluded between India and other countries?

The question of double taxation of income has been before world organisations for a long time, and it had been discussed by the League of Nations Economic and Financial Commission, consisting of Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp, who reported on 5th April 1923 their views to the League of Nations. Double income-tax covenants are due to the fact that incomes arise and are taxed in more than one country, with the result that the taxpayer is denuded of all his income, and sometimes more, under the stress of these exactions. It had been complained to the League of Nations, particularly by the industrialised nations, that great hardship was being experienced by their nationals in this matter, and they therefore requested that principles should be enunciated by the League of Nations which would obviate the possibility of the same income being taxed in more than one country. On this basis the report of the Economic and Financial Commission stated certain principles, but business conditions do not remain steady, and it was soon noticed that the conditions mentioned by the Commission would not cover all the types and instances of transactions which generally take place in the course of business. The next attempt, therefore, was that while the right of every nation to tax the income attributable to that nation was accepted, methods were proposed by which the allocation or apportionment of the income might be made between the States so as to prevent the whole income being assessed at more than one place. The key provisions to the whole study of allocation or apportionment of business income are to be found in Draft Convention No. I-A Articles 5 and 7 which deal with scheduled taxes. These articles read as under :—

“ **Article 5.**—Income not referred to in Article 7 from any industrial, commercial or agricultural undertakings and from any other trades or professions shall be taxable in the State in which the permanent establishments are situated.

“ The real centres of management, branches, mining and oilfields, factories, workshops, agencies, warehouses, offices and depots shall be regarded as permanent establishments. The fact that an undertaking has business dealings with a foreign country through a bona fide agent of independent status (broker, commission agent, etc.) shall not be held to mean that the undertaking in question has a permanent establishment in that country.

“ Should the undertaking possess permanent establishments in both contracting States, each of the two States shall tax the portion of the income produced in its territory. The competent administrations of the two contracting States shall come to an arrangement as to the basis for apportionment.

“ Income from maritime shipping and air navigation concerns shall be taxable only in the State in which the real centre of management is situated ”.

“ **Article 7.**—Salaries, wages or other remunerations of any kind shall be taxable in the State in which the recipients carry on their employment ”.

The words “ *bona fide* agent of independent status ” as used in the above quotation are intended to imply absolute independence both from the legal and economic points of view. The principle which emerges from the above convention is that where a foreign enterprise regularly has business relations in a country through an agent established there, who is authorised to act on its behalf, shall be deemed to have a permanent establishment in that country. A permanent establishment will thus exist when the agent being established in that country (a) is a duly accredited agent who habitually enters into a contract on behalf of the enterprise for which he works, or (b) is bound by an employment contract and habitually transacts commercial business on behalf of the enterprise in return for remuneration from the enterprise, or (c) is habitually in possession for the purposes of sale of a depot or a stock of goods belonging to the enterprise. In view of this definition, a broker was not such an agent, similarly the commission agent who acts on behalf of more than one person ; nor was a permanent establishment possible under the above definition in the case of commercial travellers who visited the country only for purposes of canvassing. The object of these articles was to free the enterprise or business from taxation in a contracting State where it has no permanent establishment and leave it subject to the internal law of the State in which it has a permanent establishment as defined. Thus the taxpayer who had only casual or occasional transactions in a State in which he has no permanent establishment would not be covered by the taxation of that State.

If these provisions had been accepted by the various Governments the question of double taxation would have probably been solved, but the League of Nations had no authority to impose these covenants on the various countries, with the result that the conventions which

were proposed on the report of the Economic and Financial Commission of the League of Nations were practically a dead letter as soon as the proposals had been made.

In India double income-tax relief agreements or covenants had been made between India, the United Kingdom and other members of the British Commonwealth so long as India was a dependency of the British Empire. Since then there have been introduced provisions in the Income-tax Act providing for entering into such agreements with the United Kingdom and the other nations forming the Commonwealth. The underlying idea of all these covenants has been that the taxpayer doing business in more than one country should pay one tax, and if he pays more than one, then he should be refunded to the full by the two contracting nations that which is lower of the two taxes. India's business relations are now co-extensive with the world, but its agreements do not cover all nations. In the circumstances, we suggest that the principles enunciated by the League of Nations should be followed on the part of India, which will result in only that part of the income being taxed in the outside world which arises there. The result might be that a part of the income would not be taxable to Indian income-tax. This sort of agreement is already in practice at present with Pakistan where, although theoretically India is able to tax the whole income that arises to an Indian resident, still in practice recovery of tax is not made by India in respect of the tax on the income which arises in Pakistan rate. We think that this would be a salutary method to follow in respect of other nations also. It is possible that in some cases Government might stand to lose, but equity is greater than money, and we should think that India with her stress on moral values should look first to equity and then to other things. The question then would arise as to what to do in case the income that arises outside is brought into India. We should think that if such income is brought into India and incurs the rate of tax that the trader is assessable to in this country, then the tax that is paid by him should be given credit for and the whole should be taxed at the Indian rate. In this way, what such Indian trader would pay would be only the Indian tax in effect. The next question that might arise is, if the income that is brought into India is not brought in the same year in which it arises but it is brought at a later date, how is it to be dealt with? Under the present system, an Indian, if he is a resident, has to pay tax on his total world income with the exception of Rs. 4,500, if the income from outside India is not brought into this country. If the person concerned declares such income regularly, then he would be paying the tax on the above basis. If he is not showing that income regularly and there is a hardship in his case later when he brings in the income in lump, then that hardship cannot be avoided. The party himself is responsible for it, and Government cannot be blamed if he suffers on that account in higher taxation.

In fine, our suggestion is that, as far as possible, a covenant should be made with outside countries to restrict their tax to the income that actually accrues or arises there, according to the conventions established by the League of Nations. Failing that, our second proposal is that provision should be so made that in the case of a resident whose total income is taxable in this country, due credit should be given by our country to the suffered by the tax payer to the other countries, where the income arises. We might, while on this point, invite the attention of the Commission to the first Report presented in February 1953 by the Royal Commission on the Taxation of Profits and Income in England, which deals with this question.

Question 73.—Is the present law relating to determination of “ *bona fide* annual value ” of property and deductions allowed from it satisfactory? If not, please give any alternative proposals you have in this respect.

The words “ annual letting value or *bona fide* annual letting value of property ” have been very harshly interpreted under the Indian Income-Tax Act. In fact the method of assessment under section 9 of the Indian Income-Tax Act is not strictly in conformity with the principle that income should be taxed and not anything else. Under section 9, the owner of a property is assessed on the basis of what the property is expected to fetch from year to year. It is common knowledge that expectations are not often realised, and therefore, in the first instance, the valuation itself works harshly against the tax payer. Secondly, even where the *bona fide* letting value is the same as the actual receipts, the method of taxation and the specific items that are allowed have so little relation to the actual position that the property owner has to pay on a notional income which is much in excess of what he actually gets. Thus, to take a simple example, if the *bona fide* value of a property is Rs. 12,000 a year, the deductions allowable to the property owner are :—

One sixth allowance for repairs . . .	Rs. 1,825
Half general tax	Rs. 1,050
Collection charges	Rs. 654
Insurance Premium	Rs. 120
Total	Rs. 3,649

This would leave balance of Rs. 8,351. Actually, however, the tax is at least double of what is allowed. Therefore, the maximum that the property owner is left with is Rs. 8,351 less Rs. 1,500, including the taxes that he pays on account of the tenant. Thus the property owner is left with about Rs. 6,851 in his hand, while he has to pay the tax on Rs. 8,351. Therefore he is taxed not his actual income, but much more than that. Again, out of this amount of Rs. 6,851 which is left to him he has to pay income tax, with the result that if the capital invested in the property is in the neighbourhood of Rs. 2½ lakhs, under the present system what is left with him is less than 3 per cent. on his investment. Now with this less than 3 per cent. he has to make provision for a sinking fund which would replace the money that he has invested in the property. The Tucker-Millard Committee has suggested that 1½ per cent. would be a fair margin for a sinking fund on commercial buildings as distinguished from industrial buildings; and tenanted buildings fall practically in the same class as commercial buildings. Therefore, taking 1½ per cent. of the value of the property as a fair provision for replacing capital, out of Rs. 6,851 which we assume the property owner would be left with, the actual amount that is available to him on his investment is hardly Rs. 3,518, which is just a little over 1 per cent. It will therefore be seen that the property owner is very harshly treated on the present basis under the Indian Income Tax Act, firstly, by taking as the annual letting value what he is expected to get rather than what he actually gets, and secondly, by not being allowed his actual expenditure; thirdly, he is not allowed any depreciation to replace the capital that he has invested in the property. This is illustrated by the actual figures quoted in Kilburn Properties Ltd. v/s. C. I. I. West Bengal, 1949 I. T. R. It has often been said by Government that one-sixth for repairs would cover the cost, not only of repairs, but also for replacement of the capital. This is, however, far from correct. For one thing, one-sixth provision is of the rent received and not of the value, and it has therefore no direct connection with, or relationship to, the money invested in the property. Secondly, the cost of repairs, especially in recent times, has gone up so high that property owners find it impossible to undertake even the necessary minimum repairs. Therefore, the argument advanced that the one-sixth allowance that is made for repairs would cover also the depreciation is untenable.

Our suggestions, therefore, are that annual letting value or *bona fide* annual letting value should be interpreted to mean either actual receipts or, where the properties are not let out or let out at a lower rent than due, the letting value which the Municipality or other similar body estimates as the proper letting value. Secondly, we suggest that among the allowances to be made the actual expenditure on general charges, water charges and other taxes that are payable before the income is earned, should be allowed in full. Thirdly, we suggest that just as depreciation allowance is made for business buildings and other capital used for the purpose of a business, similarly depreciation allowance should be made against the property income, such as would enable the owner to replace the capital invested in the property over the life of that property.

Question 74.—Is any change required in respect of provisions relating to carry-forward of losses? Are you in favour of allowing losses to be carried back-ward in case of cessation of business?

Regarding carrying-forward of losses, we have to refer to our submission in our Memorandum, from which we quote the following:

“Under the present Act, losses not adjusted or adjustable against the year's profits can be carried forward and can be adjusted against the profits of subsequent years for 6 years. Where, however, as is often the case in years of depression, there are continuous losses, there is no set off of such losses which, in the last resort, have therefore to come out of the depreciation. This question was considered by the Committee on the Taxation of Trading Profits in England, and the Committee's recommendations are:

“(1) That the owner of a business should be allowed to carry forward business losses and set them against subsequent profits from the business without time limit.”

“(2) That there should be a provision under which the owner of a business may carry back a loss incurred in the last year of business and set it against the assessments on that business for the three preceding years”.

“We suggest that similar concessions should be allowed in India”.

While on this point, we have to invite attention to the provision recently introduced in the Finance Act by Government enacting that losses from speculation that are carried forward should be allowed only against profits from the same business. Thus it is now enacted under the Finance Act of 1953. This is said to have become necessary because persons were inclined to buy losses. This Association has already submitted a Memorandum to Government on this question. We think that if the object of this enactment was what it was stated to be by the Finance Member, then the circumstances making this enactment necessary no longer exist. Secondly, the area within which losses can be purchased is so small that it is unfair and unjust to penalise the whole tax-paying public for what is possible in this small area. Thus losses can be purchased only in speculation and in the few cities where it is made. Speculation is a luxury that is possible only to persons who have got money to spend or people who are not afraid of losing their financial credit. By far the vast majority of the people who contribute to the Exchequer do not belong to these two classes. Moreover, purchase of losses is profitable only when large profits are made, but at present, conditions do not allow the making of such large profits. The enactment penalises a person who genuinely wants to extend his business and tries his fortune in more than one line of trading. We think that such a procedure is likely to put obstacles in the way of extension of commerce and trade, and the harm it is likely to do will more than outweigh the gains that Government expect from it. We therefore suggest that the particular provision introduced by the Finance Act of 1953 relating to speculation losses and the principle thereof should not find place in the Indian Income-Tax Act.

Question 75.—Do the provisions relating to the payment of advance tax under Section 18A of the Income-Tax Act need any modification?

The system of advance payment was first introduced during war time, more as a measure to curb the inflationary tendencies in the country than as a measure of obtaining finance, and it was introduced with the sugar-coating of interest on the payment so made. Moreover, when they were first introduced, advance payments of tax were not treated as revenue recoveries for the purposes of the budget, and they were converted into regular revenue only after the relevant assessments had been completed. Till the completion of assessments they were only advance payments and not tax receipts. Recently, Government have departed from the original idea which made the adoption of this system necessary, have abolished interest payable, and Section 18A seems to have now become a permanent feature of the Indian Income-Tax Act. Government are also taking credit for advance payments as tax receipts. This latter has had the effect of putting a brake on the work of the Income Tax Department. Instances have been quoted by various persons that their assessments are being kept hanging only because if they were completed there would be refunds due to the assessee. We have not verified the truth of this allegation, but it cannot be denied that once the tax has been recovered, the incentive to complete the relevant assessment is not so great as when the tax has still to be recovered. Government have admitted, and have been admitting, that heavy arrears in respect of assessment are still hanging on the Income-tax Department. We think that section 18A is partly responsible for this.

It is no doubt difficult for Government, having accepted the position that recoveries under section 18A are also tax receipts, to change over to the old system all at once. But this was done once in the past in 1922 when the adjustment system was abolished, and it may be possible to do it again. We are, however, not so very keen, now that the system has been in vogue for some time, that the change over should be made, particularly as we are aware that the change over would upset the financial equilibrium of the budget.

But there are in the present system many inherent defects which can be remedied. One such defect is that recovery under section 18A is made on the basis of the last completed assessment. In a period during which each succeeding year is one of greater depression than its predecessor, advance payment of tax based on the assessment of 3 or 4 previous years works as a hardship on the taxpayer. If the taxpayer were to try and adjust the advance according to his own estimate of his profits, he finds himself up against the penal provisions. An ordinary taxpayer does not know the niceties of the Indian Income-Tax Act and knows his profits only as they are disclosed by his accounts, but the Income-Tax Officer often disallows expenditure as not permissible, with the result that the actual taxable income often is more than what the books show, not because of any concealment by the assessee, but because of the interpretation of the Income-Tax Officer. In such cases, as the difference is often more than 20 per cent., the income-tax assessee finds himself penalised for making a wrong

estimate. We think that the penal provisions should be so diluted as to give the benefit of the doubt, whenever there is an increase in the taxable income as declared by the assessee, to the assessee in respect of the interpretation of not allowable deduction of expenditure. Thus, where an expenditure is considered to be revenue expenditure by the assessee but capital expenditure by the Department, if there is genuine room for doubt, then the benefit of that doubt should go to the assessee and the Income-Tax Officer should be debarred from raising penal tax.

Question 76.—Do the principles underlying the assessment under Section 34 of the Income-tax Act need any modification?

Section 34 as it appears in the Indian Income-Tax Act at present is based on the recommendations of the Income-tax Investigation Commission in 1948. The point of view of the Commission has been mentioned by them in their memorandum which is annexure A to the report of the Commission. They point out that the various decisions of the High Court in interpreting the words "definite information" in the section as it stood prior to 1948 had made it necessary that some amendment should be made in the section so as to remove the ambiguities that were causing a lot of delay and discontent among the assessees. Their point of view is summarised in this sentence in paragraph 6 of their memorandum: "Without multiplying instances, it may be stated that the view taken in most decisions as to the effect of the amendment made in 1939 is seriously prejudicial to the interests of the public revenue". In other words, they lay greater stress on the administrative side of the section than on the equity side. In paragraph 8 they mention "the honest tax payer whose accounts are straight has little to fear. It is only the person who will not keep proper accounts or will not choose to produce them that can ordinarily be subject to proceedings under section 34. The mere initiation of proceedings under section 34 cannot, even in such cases, be deemed to be a great hardship, except to the extent that the assessment proceedings are reopened". They further say "It is not always possible to say how much was present to the mind of the Officer who examined the accounts in the previous year. The mere fact that the books were before him cannot always be taken to imply that nothing would have escaped his attention". In effect the Commission therefore was of the view that if there are any mistakes on behalf of the Income Tax Officer in fact and law, or any omission on his part due either to negligence or to ignorance to know the implications of the accounts before him, still it is the assessee who should suffer by his case being re-opened; and not only is the case to be reopened for 4 years, but it is to be reopened for 8 years, as if the income-tax assessee had committed fraud or concealed his income even when all the facts were in the accounts which were before the Income-Tax Officer. We think that this outlook of the Commission has affected the Legislature which, in enacting the present section 34, has laid too many shackles on the hands of even the honest taxpayer.

The English Committee on the Codification of Income-Tax Law recommended that for the words "discovers" which occurred in section 125 of the English Act it would be preferable to substitute the words "comes to the conclusion". The corresponding provision in the Australian Income-Tax Assessment Act, 1936, makes the amendment of the assessment depend on whether or not the taxpayer has made to the Commissioner a full and true disclosure of all the material facts necessary for his full assessment, and there has been avoidance of taxation. It will be seen from the above that neither the English Act nor the Australian Act goes as far as the Indian Act in the matter of re-opening of assessments. To hold the assessee as having concealed income even when the accounts produced by him contain full particulars is to accept an interpretation of the word "concealed" which is justified neither by the law nor by the dictionary meaning of the term. We have no objection to cases being re-opened by the Income-tax Officer, because we acknowledge that the person who knows the facts better is the assessee, and the Income-tax Officer, therefore, is working under a handicap in finding out the true aspects of the case that is presented by the intelligent assessee. But on that account to equate the Income-tax Officer's negligence or ignorance to the concealment by the assessee of his income is, we think, unwarranted by any canon of jurisprudence or equity. We therefore suggest that the eight-year limited extended to facts that come to the knowledge of the Income-tax Officer in respect of the accounts produced before him should be reduced to 4 years.

Another hardship of section 34 which indirectly has arisen out of the wording used in the section needs to be reminded. The Income-tax Investigation Commission have themselves said "Few will maintain that a mere change of opinion on the same facts could justify a reopening of an assessment", and yet the same Commission have, in one of their recent Reports to Government,

allowed themselves to be persuaded to reopen an assessment on no other ground than a change of opinion. In that case, a Company had taken over the shares of another Company, which thereupon went into liquidation. The business assets of the liquidated Company naturally came over to the purchasing Company, which thereupon continued the business. When, however, the purchasing Company claimed depreciation, the Income-tax Department objected to it on the ground that the purchasing Company had not purchased the machinery, but had merely purchased the shares. But the Appellate Assistant Commissioner, deliberately and after considering this very question, gave his decision in favour of the assessee that the substance of the transaction was that the machinery and plant had also been taken over as a result of the purchase of the shares. The authorised official of the Income tax Investigation Commission, however, when he incidentally came upon this case thought otherwise and reported to the Commission that the decision of his predecessor in the Income-Tax Department and of the Appellate Assistant Commissioner was wrong, and that the Commission should reopen the case and assess the Company by disallowing the depreciation. The Commission did so, and yet this was the same Commission that had held the view that mere change of opinion on the same facts would not justify the reopening of an assessment. When an august body like the Commission takes this view, it is not surprising that the Income-Tax Officers also should take a similar view on much less pretexts than those of the Commission. We think that this procedure works a great hardship on the taxed public who, therefore, can never be sure of the finality of their assessments; and to keep the assessments pending thus for 4 or 8 years after the assessment year is over adds to the hardship.

Again, to quote the instance of the Commission, the Commission was started in 1948; it is now nearly 6 years that it has been working, and the period of investigation dates from 1st January 1939. Assessee are therefore expected by the Commission to preserve accounts in all their details from 1st January 1939, and where this is not done, naturally the Commission takes an adverse view; and when they take an adverse view on a question of fact, there is no appeal and the assessee is at the mercy of the Commission and the Department. The problem is not so acute in the case of the ordinary assessee, but even so the hardship is practically the same. A person, after his case has reached finality, is entitled to think that the records necessary to substantiate his return would no longer be necessary, and therefore he does not attempt to preserve them. But if the case is reopened 4 years thereafter and he is unable to produce the books or the proofs on which he relied at the time of the original assessment, the Income-tax authorities will accuse him in the first instance of having destroyed the accounts, and even if they do not do so, they will judge against him on the ground that the accounts are not available. It is a contingency like this that makes the provisions of section 34, particularly in relation to the time limits laid down in it, very oppressive. We have no objection to the four-year limit, but the penalty limit should not exceed, we think, more than 6 years; and then again it should be further enacted that if since the date of the first assessment accounts are not preserved by the assessee, no adverse conclusion should be drawn against him, whatever be the view of the Income-tax Officer about the escaped income. It is no doubt true that this might give a handle to dishonest assessee to deny accounts after they have managed to get through a lower assessment in the first instance, but we do not think that the loss of revenue on this account is going to be so great as the loss of equity on the other side. It has to be presumed that when the Income-Tax Officer takes action under Section 34, he does so on the strength of some independent evidence and not on the books of the assessee himself. Therefore, by introducing such a saving clause as suggested above, a dishonest assessee is not likely to escape the consequences of his concealment. Moreover, there are already so many inspections provided for in the Income-tax department—first by the Inspecting Assistant Commissioner, then by the Commissioner, then by the Directorate of Inspection—that escapement of assessment on facts known to the Department would not go undetected for four years. Our suggestions, therefore, are:

(1) that the cases should not be reopened merely on account of change of opinion on the same facts;

(2) that if the accounts had been produced before the Income-Tax Officer at the original assessment, and new facts come to the knowledge of the Income-Tax Officer later which are to be found in the same accounts which were originally produced, then the period of reopening should not exceed 4 years;

(3) that the maximum time limit for reopening instead of being 8 years should be 6 years.

Question 77.—What measures would you suggest for simplifying the procedure of assessment in order to reduce the cost of compliance with tax regulations?

The Income-tax Codification Committee, under the Chairmanship of Lord Macmillan, was appointed on 31st October 1927 and presented its report to Parliament in April 1936, and at the end of their 9 years' labour they drafted a Bill which they thought could provide two things, viz., "as plain a statement as is possible of the law which regulates the liabilities of the British taxpayer in these days of fierce competition between nations when it is of vital importance to encourage the establishment of fresh industries in this country and to preserve unimpaired its position as the centre of world finance, and a clear indication of the burdens to be borne by persons doing business in or with this country". The fruit of their labours of 9 years has not yet been translated into legislation by the British Government, although in the new Bill of 1952 they have given effect to some of the recommendations. The above is stated only to impress that codification of Income-tax Law so as to make it simple and intelligible to the common man is beyond the ability of ordinary individuals, the complications of business, the unreliability of words to carry intended meaning and the ingenuity of the tax evader being so great and baffling that a structure that can meet all the requirements is difficult to set up even ordinarily, much less in an easily intelligible manner.

One of the methods by which simplification would have been possible was to introduce a system of taxation at source at more points in the Indian Income-tax Act than is done at present. But the small experiments that have been made in this direction have not yet been successful enough first, because total income under the Indian Income-tax Act does not cover income such as agricultural income and secondly, because deduction at source on interests and rents requires an educational qualification with the tax payer and also with the non-taxpayer who makes these payments, which is not yet reached in this country. We would not, therefore, advise an extension of the system further in this country at present.

One suggestion, however, we may be permitted to make, and that is that in order to simplify the system under section 18A and other similar provisions, an assessee who makes a return might be allowed to make his payment along with his return on the basis of the income that he declares. This has two advantages: one is that the Government will be able to get the tax quicker; secondly, the assessee will try to understand his position better under the Indian Income-tax Act, and an understanding taxpayer creates less difficulties than one who does not try to understand his obligations, but along with the change, if it is accepted, it should be also enacted that no penalty should be charged to the tax payer, if his estimate is honestly low.

Also, instead of making too many alterations in the form of return, we would suggest that the form of return of income should be made as simple as possible and should contain only the bare outlines of the requirements for income tax assessments. On receipt of this form, the Income-tax Officer should ask for further details from the assessee by correspondence. For this purpose, tables that now form part of the income tax return should be used, so that only those tables which are necessary for an assessee to concern himself about, reach him. He is therefore in a better position to concentrate his mind on the particular aspect of the position and give his replies more satisfactorily. In this way the understanding between the assessee and the assessor will be better and the work disposed of quicker.

The Income-tax Investigation Commission had proposed in its report the employment of Public Relations Officers. The underlying idea of the Commission evidently was that such officers should help income-tax assessee in making their returns and to act as liaison officers between the public and the Department. We have seen such Public Relations Officers working in some places, and the experiment, we are sorry to say, has not been as successful as was expected. At least, the work that was done by the Public Relations Officer was not what was intended by the Commission or, if the Commission has been misunderstood, what was expected of him by the public. Merely helping speedy recovery of refunds is not the be all and end all of a Public Relations Officer's duties. Unless the Public Relations Officer is given more responsibility and greater opportunities to persuade his colleagues in making proper assessments, the appointment of such officers is not worth the money that is spent on them. With the proper working of the system of Public Relations Officer, the returns would be more correct, the approach of the taxpayer would be more helpful, and the relations between the public and the tax gatherer would be more cordial. If Public Relations Officers are to be appointed, the justification will lie only if these objects are achieved.

Question 78.—It has been suggested that the Appellate Tribunal should have powers to enhance assessments in the same manner as Appellate Assistant Commissioners have. What is your opinion?

We agree that the Appellate Tribunal should not be denied the power to enhance assessment. But the question then would be, who is going to be the appellate authority against the decision of the Appellate Tribunal when they enhance the assessment? The point is that however eminent a Tribunal may be, it would be incorrect to say that they will make no mistakes or that their opinions would be always correct. We should think that as there is no other authority superior in the matter of income-tax appeals to the Appellate Tribunal, that same Tribunal must find from among themselves a superior authority to hear appeals on enhancements. We would suggest that where an assessment is enhanced by one Bench of the Appellate Tribunal, the appeal should lie to another Bench consisting of 3 or more members, none of whom should have been a member who, was party to the enhancement of the assessment.

Question 79.—Do you recommend that an element of progression should be introduced in the corporation tax?

Under the present system, corporations are taxed in India both to income-tax and to corporation tax. We think that there is a good deal to be said in favour of this system. The two taxes stand for two different principles. Income-tax is paid on behalf of the shareholder under the Indian Income-tax Act, but the corporation tax is a contribution by the corporation to the State for the special facilities, such as legal and business security, which the Government provide to corporations. We are therefore of the opinion that the system in vogue at present of having income-tax on corporation income as well as corporation tax should continue. In effect, under the present system the corporate pays only one tax, viz., the corporation tax. This is in accordance with the theoretical argument that the ultimate owners of the income and undivided profits of the corporation are the stockholders. The corporation is merely a shell. It does not have any direct ability to pay taxes. The true ability to pay taxes rests with the owners.

We do not think that the taxation of corporation should be progressive. Progressive income-tax is impersonal in character and draws no distinction between stockholders. Such a tax would take a good deal more from the low income stockholder. Secondly, as the corporation usually consists of middle class men and as no relief is to be given to the shareholders in respect of the corporation tax, it will be taxing the stockholder doubly if the corporation tax also is made progressive.

There is, however, this to be said in the case of small income corporations, that the present Act does press heavily on them, but, as usually these small corporations are private companies, there is no harm, we think, in making them pay the same rate of super-tax or corporation tax as the other companies.

Question 80.—Would you advocate different rates for different types of corporate enterprises, e.g., (i) small industries, (ii) cottage industries, (iii) private limited companies or what may be termed proprietary companies, (iv) holding companies?

We are not in favour of providing different rates for different types of corporate enterprises. As we have said already, the corporation tax should be uniform, and if for any reasons differentiation is introduced, it will be difficult to know where to stop.

Question 81.—There is a demand for the exemption of inter-corporate dividends from corporation tax. Do you consider this justified and, if so, why?

In view of the fact that we have recommended that the corporation tax should be uniform as a measure of contribution by the corporation for the special facilities allowed to it under the Government legal system, it follows that inter-corporate dividends should not be taxed over again. No doubt there is this danger, that if there are monopolies, this inter-corporate system might be utilised to set off the loss of one against the income of the other; and this danger was present before the mind of the legislators in the U. S. A. who enacted that where inter-corporate dividends received by a parent company, only 15 per cent. of this dividend should be taxed in the hands of the parent Company and the 85 per cent. should not be taxed. We think that this is a good compromise formula which will meet the objections of those who are anxious to plug all loopholes for manipulation of income and of those who feel the injustice of the same income being taxed twice over.

Question 82.—Do you think that any special provisions are necessary for the assessment of—(a) banks; and (b) investment companies? Do existing rules relating to assessment of insurance companies, especially mutual insurance associations, require any change? If so, in what respect?

(a) We are in favour of special provisions being made for the assessment of banks and investment companies. Professor Grouse in his book on "Financing Government" has recognised four characteristics of banks which differentiate them from other businesses and which are relevant to taxation:

- "(1) Banks carry a stock of intangible goods.
- "(2) Some banks are chartered by the Central Government.
- "(3) Banks possess credit creating power.
- "(4) Banks are heavy holders of Government Securities".

By "intangible goods" Professor Grouse meant promises and orders to pay, such as notes, bonds, paper money and balances on other banks. Ordinary businesses usually hold tangible goods which are generally taxed under the ordinary levy. To tax the banks on their intangibles raises the problems of discovery valuation and double taxation, because intangibles are commonly representative of or secured by other tangible property. In the U. S. A. there have been special legislations for taxing Federal banks owing to money difficulties experienced. It is necessary, in view of the special characteristics of banks, that adjustments in respect of tax structure should be made to relate to the economic characteristics of the bank, according as they are exchange banks or credit banks or otherwise.

(b) The special position of investment companies has been recognised under the Indian Income-tax Act, and it has been provided that where investment companies which are recognised as such by the Central Board of Revenue receive dividends from other companies or corporations, such dividends should not be taxable to corporation tax in their hands. This is as it ought to be, but the difficulties that are raised in the recognition of an investment company as such by the Government make the progress of investment companies very slow and in secure under the present administration; Secondly, it is not understood why only a public company, whose shares are in fact transferred on a stock exchange, would enjoy the privilege and not any other company. We suggest that there should be greater incentive provided to start investment companies, Government who have themselves recognised by the starting of finance corporations the advantage underlying investment companies, should appreciate this point of view.

The Income-tax Investigation Commission in paragraphs 103 to 126 of their report deal with the question of assessment of life insurance companies. We are in agreement with the views expressed therein, with this exception that we think that the claim of the insurance companies for a deduction of the full bonus amount to the policy holders should be accepted. The Commission has not been able to give any cogent reason for reducing the amount.

Regarding general insurance companies, we think that the method that obtains in India at present follows the system which is employed in the United Kingdom. In the United Kingdom provision is allowed for risks, but the proportion of such provision which is usually accepted is low as compared to the requirements of Indian companies, because in India reinsurances are mostly to be made with companies in the West. This is partly because our companies are new and have not sufficient resources. It is therefore necessary, in order that our companies might build up their reserves, that their claim for reserves should receive more sympathetic consideration than now.

We would also suggest that general insurance should be treated as one where fire, marine and other departments are run by the same company. These departments, although they bear separate names and have distinct clients, are run on similar lines, the risk is the same in all branches, and the profit and loss is worked on similar principles. For the purposes of income taxation, we think that the losses of fire and other departments should be treated as one and they should be allowed to adjust losses suffered by the other branches of general insurance done by the same company.

About mutual insurance associations, the present system is to tax income derived by the association from investments, property, etc. Most of the properties are used by these associations as their offices and no actual rent is received. In effect, therefore, what happens in taxing the properties is that the tax has to be paid from voluntary contributions. We think that in such cases where the property is being used by mutual insurance associations for their own purposes as an office or a stadium, the income from the property should be exempted.

Question 83.—Do you think that differentiation should be made between distributed and undistributed profits of companies for tax purposes? If so, on what grounds? What change would you suggest in the present quantum of differentiation in favour of undistributed profits? Should the concession in future be restricted to particular industries?

If the tax concession in favour of undistributed profits is allowed to continue as at present or in a modified form, what measures would you suggest to ensure:

- (a) that retained profits are not used as a device

by shareholders of private limited companies to evade super-tax;

- (b) that retained profits are actually applied for productive purposes?

In particular, are the provisions of Section 23A of the Income-tax Act satisfactory? If not, what changes would you suggest?

We agree that there should be a difference of treatment regarding distributed and undistributed profits of companies for tax purposes. But at present Government allow only one anna rebate for undistributed profits, but that rebate is not sufficient incentive. We have said earlier that where a part of the income of an industrial undertaking is ploughed back into the business for the purposes of expanding or improving it, the expenditure should be allowed as a deduction. As a corollary to this, we would suggest that where undistributed profits are thus set apart and finally used for the expansion or improvement of the business, proper reductions should be made in respect of such expenditure so incurred out of undistributed profits.

We do not think that any special safeguards are necessary. It is possible to enact a time limit within which such profits are to be brought into use. We think that the period so prescribed might be about 6 years, unless it is extended with the permission of Government on proper reasons being shown.

The main objection that has been time and again advanced against the provisions of section 23A is to the words "having regard to the losses incurred by the company in earlier years, or the smallness of the profit made, the payment of a dividend, etc."

These words necessarily indicate that what is to be taken into account is the smallness of the profit as it is in the books. But this is not considered as such by the Income-Tax Department who often look to the assessable profits, and this has meant a considerable hardship to honest corporations which have been assessed under a higher income owing to the provisions of the Indian Income-tax Act, although according to the balance sheets the profit available to them is much smaller. We therefore think that the word "profit" here should be interpreted to mean the book profit and not the assessable profit. Secondly, the question of the definition of "public limited company" has caused considerable difficulty. As a rule, when a company is started, the public are not receptive to its claim of doing good business, and it is only after the business has established that capital slowly comes in from the outside. During the interval, all the risk is taken by the persons who start the business, and necessarily, in these circumstances, the capital comes in from their relatives and friends. The word "Public" has therefore to be understood in a much narrower sense than the interpretation given to it in the dictionary. In England the word used is "control", and it has been established that for the purposes of control even a near relative like a niece would be considered to be a member of the public. We think that a similar amendment should be made in the Indian Income-tax Act as well.

Question 84.—Do you think, in view of the fact that profits distributed by a company are subjected to corporation tax, it is appropriate that they should also be charged to super tax in the hands of shareholders? If not, what are your suggestions in this regard?

In view of the definition we have already given that corporation tax is a tax paid for corporation, it stands to reason that when the dividends are received by a shareholder, he cannot claim exemption in respect of these dividends for super-tax on the ground that these dividends have suffered corporation tax in the hands of the corporation.

Question 85.—Would you consider that industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies should be required to contribute, from their earnings in the way of Income-tax or in other ways, to general revenues?

We see no reason why undertakings run by the Central Government, the States and the Local Bodies should be exempted from tax. It is no doubt true that because these undertakings are owned by Government, the Government being the owner and not being one of the persons mentioned in the Indian Income-tax Act, there is no way of taxing the income of these undertakings. But in principle, we think that the Act should be amended so as to bring under taxation the profits of these undertakings. In effect, if the undertakings make a profit, that profit would go to Government. If they are taxed, the profit will go to Government in two different channels, one by way of tax and the other by way of profits. In effect, therefore, taxation is not going to make any difference so far as the tax payer is concerned, but it will have the moral effect of showing to the public that Government make no distinction, so far

as commercial undertakings are concerned, between those run by them and those run by others.

Question 86.—*What measures would you suggest for the greater use of the services of Chartered Accountants for assisting in the determination of the taxable income of assessee? What obligations should be placed on a Chartered Accountant when he certifies a statement of accounts of an assessee for purposes of income-tax assessment? In particular, with a view to minimising evasion of tax, would you recommend that certificate of a Chartered Accountant should invariably accompany the return for business income over a certain limits? If so, would you suggest that a form of certificate should be prescribed indicating the scope of the check that should be exercised by Chartered Accountants who render the certificate mentioned above? Do you agree that fees payable by assessee to Chartered Accountants for such certificates should be restricted to a schedule to be prescribed by Government?*

We would welcome the greater use of the services of Chartered Accountants for assisting in the determination of the taxable income of the assessee to income-tax, and we also think that just as a Chartered Accountant is held responsible for the certificate which he furnishes after the audit of a company's accounts, a similar liability be placed on the Chartered Accountants on their certifying accounts for purposes of income-tax. There is nothing inherently wrong in laying such a liability on the Chartered Accountant. The form of certificate might be prescribed by the Institute of Chartered Accountants.

Regarding fees, we agree that they should be according to schedule prescribed by Government. In England the word "Chartered Accountant" has got a much wider meaning than in India. In fact, practically any one who passes an examination, small or big, in accounting is accepted as a Chartered Accountant in England, while this term is restricted in India to those who acquire the qualification after an examination combined with an apprenticeship lasting for a period of five years. Naturally, the fees charged by a Chartered Accountant in India would be correspondingly higher, and they may not always be such as can be suffered easily by all classes of assessee.

Those, however, who prefer to have the services of Chartered Accountants stand in need of being protected from being mulcted of high fees and this should be avoided by laying down a schedule which the Institute of Chartered Accountants thinks to be fair.

Question 87.—*What changes would you suggest in the present law relating to the representation of assessee before Income Tax authorities (Section 61) in order to ensure—(i) effective representation of assessee at reasonable fees; (ii) a minimum level of proficiency on the part of representatives regarding the subject of income-tax law, rules and regulations?*

The Income-Tax Investigation Commission has referred to the question of the representation of assessee before the Income Tax authorities. We would invite the attention of the Commission to the remarks in this matter. They have laid stress on the fact that only such persons should be allowed to appear as have the necessary qualifications of education or experience in the matter of income-tax. We agree that persons who are so entitled to appear should have the minimum qualifications in education prescribed for entry into service, that they should be either qualified in law or in accountancy according to the examinations set by the Universities and by the Institute of Chartered Accountants, and in addition, those also should be allowed to appear who by their experience either as Officers of the Income-tax Department or of service as accountants in firms, companies and institutions are qualified to conduct cases in Income-tax law and procedure. In the case of the latter, who do not hold qualifications recognised by Universities or by the Institute of Chartered Accountants, their recognition should lie with the Commissioner of Income-tax, for the State and by the Central Board of Revenue for the whole of India. We are strongly of the view that assessee should be allowed to be represented by such persons, in view of the fact that the large majority of assessee—in fact, over 5½ lakhs out of the 6½ lakhs who were assessed in 1951-52—came from the lower bracket, can hardly bear the burden of the heavy charges of engaging lawyers or Chartered Accountants with their scales of fees.

Question 88.—*Will it assist in checking evasion if the names of the persons who are penalised for concealment of income are published?*

The Income-tax Investigation Commission has recommended that the names of persons who are penalised should be published. We do not think that this type of publicity is likely to help in the matter of searing people from evasion of tax, especially those who are so minded. The penalties as they are prescribed under the Indian Income-Tax Act are for petty offences like not making

a return within the proper time, as well as offences of a serious nature like fabricating accounts with a view to avoid proper incidence of tax. It would mean a great hardship to honest men who are not very regular in filing their returns or in keeping their accounts that they should be bracketed with deliberate evaders of tax, and deliberate evaders of tax are so thick-skinned that they would not mind their names appearing on the Notice Boards of Income-tax Officers as evaders of tax. We do not think that in the present state of the public conscience it is likely to make any difference if the names of persons who are penalised by the Department are published.

Question 89.—*Do you think that the present practice of excluding, from taxable profits, perquisites given to employees of business undertakings results in considerable loss of revenue? If so, please state the perquisites you have in mind, and how they should be dealt with for the purposes of taxation.*

This provision of excluding from taxable profits perquisites allowed to their employees by firms and companies was proposed to be introduced in the Income-tax Bill which was circulated in 1952. The proposal met with a large amount of opposition. Part of this opposition naturally came from interested quarters, but it cannot be denied that there was a substratum of truth behind the opposition. If it is admitted that certain expenses are necessary for employees to incur for the purposes of the business of their employers, the question of allowing perquisites does not stand merely on the ground of justification of the allowance, but has to be judged from the point of view of its quantum. Under the Income-tax Act only house rent is considered to be a perquisite, but there are other allowances which can come under the category of perquisites and which can raise, therefore, a controversy about the quantum to be allowed. We have no objection to leave some discretion to the Income-tax authorities to determine the proper quantum. We, however, feel that once it is admitted that the Income-tax Officer can have the right to adjudicate on the proper quantum to be allowed, difficulties will arise which will often prove insoluble. Thus the quantum being a question of fact, the assessee cannot go for relief to the High Court, and the Income-tax Department as at present constituted does not seem to exercise more than one mind on the issue before it. The Appellate Tribunal is the only power at present which stands between the assessee and the Income-tax Department and is inclined to look at the questions placed before it with an impersonal and judicial eye. But even so the problems will be so many and accounting will be so difficult that even they will find themselves greatly handicapped in ascertaining the due proportion. While admitting, therefore, the equity of the proposal that some rule should be made by which the quantum of perquisites to be allowed to assessee should be determined or laid down, we are against the Income-Tax authorities being made the final arbiters as regards this quantum. Perquisites, in the large sense of the word which we have in mind, are travelling expenses to be allowed to the employer, conveyances charges to be allowed, entertainment expenses to be allowed, house rent to be allowed, and other expenditure which through not strictly legal, but has according to business conditions to be necessarily incurred in expediting business contracts.

Question 90.—*In the case of a company under liquidation, what steps, if any, would you suggest for safeguarding payment of tax dues before any payments are made to shareholders?*

In the case of a company under liquidation, the steps to be taken would be those which have been suggested by the Income-Tax Investigation Commission, with whose recommendations we are in agreement.

Question 91.—*Do you think that, in order to minimise evasion and avoidance of tax, there is a case for conferring larger powers on income-tax authorities? If so, what further powers should be given to them? In particular, should powers to search premises and seize documents and books of accounts be given to Income-tax authorities? If so, what is the lowest grade of officer on whom you would confer these powers?*

We do not think that additional powers of the kind that have been advocated on behalf of the Income-tax Department should be allowed or are necessary for the Income-tax Officers. In particular, we do not think that powers to search premises and seize documents and books of account should be given to Income-tax authorities. Such powers were given to the Income-tax Investigation Commission. During the last 6 years during which the Commission has been functioning, the number of occasions on which the powers were used was hardly half a dozen. We therefore see how infructuous these powers were even for the purposes of the Income-tax Investigation Commission. The reason is that these powers can easily be evaded. Even assuming that a person has got a double set of accounts, all that he has

to do in order to escape the clutches of the Income-tax Officer is to keep them at a place other than his place of business, and the Income-tax Officer would be baffled to discover their whereabouts, and a search can only mean harassment without any tangible result. On the other hand, the power of search always means that there is some one who is giving information to the Income-tax Officer against the assessee. That person would usually be a man of not very high principles, and more often than not he would egg on the Income-tax Officer to make his search, in order to gain his personal ends or to wreck vengeance. Income-tax Officers have hardly any time or the necessary education to judge properly the merits of such proposals made to them. Therefore we think that more often than not the power to search premises is likely to be misused than to result in gaining the ends of the proceeding.

One power, however, which might help the Income-tax Officer to strengthen the evidence in his hands is the power to give immunity to an informer from the consequences of his disclosure. This is the power which is at present given to the Income-tax Investigation Commission and is practically the only power, apart from the power to search which the Income-tax Investigation Commission possesses, in addition to the powers already enjoyed by the Income-tax Officers. Once the immunity is given, the Income-tax Officer will be in a position to use the evidence in the hands of the informer, and thereby the tax evader will be hard put to it to defend his false case. We therefore think that this power may be given, and it should be given to all Income-tax Officers, to whatever grade they belong.

Another power which might be given to the Income-tax Officer is to stop proceedings of recovery in case the defaulter approaches him with terms of settlement for payment of tax. Under the present Act, the Officer, once he sends his recovery certificate to the Collector, has no power to stop the recovery, and if the Collector goes on with the recovery proceedings, much harm to credit might be done even in the case of those who are anxious to meet their liability in their straitened circumstances. We think that this power might therefore be granted to the Income-Tax Officers.

Question 92.—What precautions are necessary and possible to prevent the creation of an artificial legal entity—a trust or a private limited company or a partnership, especially family partnership—either for avoiding payment of income-tax or for fractioning of income to escape higher rates? Would you recommend the use of penalty rates of tax to minimise such practices?

There are powers enough at present with the Income-tax Officer to prevent the creation of an artificial legal entity or, if not to prevent the creation, at least to make one ineffective for the purpose. We do not think that the use of penalty rates to minimise such practice are going to help in any way. We are therefore not in favour of such penalty rates being introduced.

Question 93.—In the case of a registered firm, would you advocate recovery of unrealised tax of any partner from the firm as such or from other partners?

In the case of a registered firm, each member or partner of the firm is considered as a separate individual for the purpose of assessment. Therefore, theoretically there does not appear to be any justification for recovering from a member of a registered firm or asking a partner of a registered firm, to pay the liability of tax of another partner. But if we consider the legal concept that the partner of a firm, whether the firm is registered or unregistered, is an agent of the firm and is entitled to act on behalf of the firm, it has to be admitted that in law the liability of the partner of the firm should be joint and several, and what would apply to an unregistered firm would apply equally to a registered firm. In fact, even under the Income-tax Act, for the purposes of penalty, the income of a registered firm is considered as a whole, even as the income of an unregistered firm is so considered, and therefore we see no difference in the status of the partner of a registered firm and that of an unregistered firm, except that they are treated differently for the purpose of assessment.

Question 94.—Are present arrangements relating to recovery of income-tax adequate? Would you advocate the Income-tax Department having a separate machinery for enforcing the recovery of arrears of tax?

We think that the present arrangements relating to the recovery of income-tax are adequate, except to the extent of the liabilities due on account of taxation from companies which go into liquidation or are dissolved. In respect of these, the Income-tax Investigation Commission in their report have already suggested that the liquidator should set apart enough funds for meeting the liabilities of the tax and that he should be held responsible if he fails to do so.

We are not in favour of a separate machinery being established for enforcing the recovery of arrears of tax.

In fact, the Department has got a separate machinery under its own administration, and this is sufficient for the purpose in view.

Question 95.—What provisions should be made to ensure timely collection of tax from private limited companies? Do you consider that liability for payment of tax in such cases should be placed upon shareholders of the company in proportion to their shareholdings?

We think that private limited companies should be considered as partnerships so far as the collection of tax is concerned, and the directors of such private limited companies should be made liable for paying the tax due from the private limited companies, even as the partners in a registered firm or an unregistered firm are liable for the tax due from the other partners of the firm if it is not paid within time. As a rule, directors and shareholders are practically the same in the case of private limited companies, but where such is not the case, we think that the shareholders also should be held responsible for the payment of the tax in proportion to their shareholding.

Question 96.—If income from any property is included for assessment purposes in the hands of a person other than the ostensible owner, would you agree to the tax so assessed being also made recoverable from such property?

We agree that where for the purposes of assessment a property is included in the income of other than the ostensible owner, the tax should be recovered from the ostensible owner. We refer, in fact, to the provisions of section 16 of the Indian Income-tax Act, where the income for a property acquired in the name of the wife with funds provided by the husband is considered for taxation in the hands of the husband. It seems to be unfair that the husband should pay the tax from his own income and Government should not be able to make recovery from the wife merely because the assessment on the income of the property is made in the name of the husband.

Question 97.—What concrete measures should be taken to improve the relations of the Income-tax Department with assessee, especially in regard to—

- (i) Provision of free advice to small assessee on the following points:
 - (a) maintenance of accounts in a form acceptable to the Income-tax Department; and
 - (b) matters such as filing returns of income, claiming refunds, facilities for tax payment, expeditious disposal of assessments, etc.;
- (ii) provision of information on various matters relating to assessment proceedings, such as disposal of refund application, adjournment applications, examination of records, etc.;
- (iii) arrangement of work so as to obviate the necessity of assessee or their representatives having to wait in Income-tax Offices for unduly long periods; and
- (iv) securing the largest measure of agreement on facts between the assessee and the department at Income-tax Officer level?

The Income-tax Investigation Commission has devoted a considerable portion of their report to the administrative side of the income-tax machinery, and they have made certain suggestions for improving the relations between the public and the Department. With these recommendations we are in full agreement.

We may, in this connection, refer to what we have said in our Memorandum submitted to the Commission. We quote the following from it for easy reference:

"This goodwill should be supplemented by a change in approach by the Department. The latter have to perform a duty, which no one looks upon as a bed of roses. It can be said to the credit of the Department that during the last 30 years and more during which it has been functioning in this country, it has on the whole maintained a sound reputation. That reputation can be improved, if the public are made to feel that the honest have nothing to fear from the members of the Department. The Officers of the Department should, when they are making assessments, remember that the assessee are their own compatriots and as such they are entitled to the presumption from these officers that they are honest and are telling the truth until the contrary is proved. Such an approach will not require greater sacrifice of either time or temper, but the little change for the better will pay a dividend in better relations, that is worth all the revenue in the world.

"On the part of Government they must appreciate that the work being done by the Department is intricate. Since the Department was started, it has been organised and controlled by persons who, though able, had not that personal experience of all stages of Departmental work which is necessary to organise the administration. . . . The Department should be adequately manned."

We also quote from a book entitled "Taxation and the American Economy" by W. H. Anderson, on which we have drawn for many suggestions. This is what the author says:

"While it is true that efficient administration is necessary for the success of any tax, it is especially true of the income-tax. The nature of the income-tax requires the highest degree of co-operation between the tax administrator and the taxpayers. It is vital for the taxpayers to feel that the administration is fair and equitable. Naturally it is impossible to administer income-tax law in such a manner as to satisfy every one. Many conflicts are bound to occur. A number of these conflicts are a result of the law itself; others are due to judicial weaknesses, and some are caused by administrative faults. Much room for improvement remains in strengthening the two prongs of income-tax administration and compliance."

(1) (a) We agree that there should be provision for free advice to small assessee, but this is more easily said than done. Except in large cities, it is not possible for the Department to provide for free advice to all assessee, and the machinery that would be necessary for such free advice if it is provided for would itself be so large that it might become a heavy burden on the exchequer. It is no doubt true, however, that the Income-tax Officers, while making an assessment, should be able to guide the assessee as to how the accounts should be maintained by the assessee and also point out the defects that his accounts contain. The present attitude of the Department is, however, not very helpful. The Income-tax Officer, more often than not, aims at criticism and at finding loopholes for rejecting the accounts as unreliable when they are produced by the assessee, and instead of helping the assessee to be self-reliant and honest, the attitude of the Income-tax Officer often throws him into the other camp. It is not enough that the assessee should be informed how to maintain accounts, but it is more necessary that the Income-tax Officer should appreciate the difficulties of an assessee in maintaining the accounts according to the strict letter of the Accountancy Code. Thus in the case of a retailer, the Income-tax Officer expects that the retailer should maintain not only an inventory of the goods in stock at the end of the year, but also prove the correctness of the amounts or quantities of each kind of goods contained in the inventory. This is a task which every sane man knows to be impossible, and yet in 99.9 per cent. of the cases of retail traders the Income-tax Officer rejects the accounts on the ground that the stock lists have not been proved, and subjects the assessee to an estimated assessment which is much in excess of the income according to the books. Even in cases where accounts are maintained on recognised principles, holes are picked in those accounts just to discredit them. Unless, therefore, this attitude of the Department is changed, no advice, whether free or paid, is going to assist the assessee or to make the relations between the assessee and the Income-tax Officer cordial. We therefore think, better than the provision of free help, the attitude of the Department towards the accounts maintained by the assessee should be changed and should be more helpful.

Regarding filling returns of income, claiming refunds, facilities for tax payment, expeditious disposal of assessments, etc., there can be no two opinions that the Department can do a great deal in order to help the assessee. In some large cities, especially in Bombay, there had been established an Enquiry Branch where assessee are being helped to fill returns. Now that Public Relations Officers are being appointed, it should be easier for this Branch to help the assessee in this matter, and also in guiding them so far as claims are concerned or for payment of tax.

(b) Expedition in the disposal of assessment is, however, more difficult to arrange merely by theorising. The machinery of administration at present is such that there seems to be a lack of confidence by Government even in their own officers of the Department. Thus when an Income-Tax Officer makes an assessment, the Inspecting Assistant Commissioner, without even taking the trouble of knowing the assessee's point of view, gives orders which are often prejudicial to the assessee. The Appellate Assistant Commissioner is hardly ever helpful. A good many have complained that the assessments are made haphazard. This is not to be wondered at. The Department has been expanding at the top and very little help reaches the end where the Income Tax Officer works. He is only to accept dictates without either the time necessary to digest the information on the assistance to sift it. Then there are further requirements in the shape of a variety of departmental returns which take away most of his time. Thus he finds hardly enough time to concentrate on his work. These and various other defects are hampering the work of the Income-tax Officer, and unless the Officer is set free from the restrictions of injudicious control and other departmental requirements, the speed can never improve. We

think that the first requisite for the speedy disposal of assessment is that the Income-tax Officer should be given a free hand. There is now an appeal provided against him by the Department itself, and therefore it seems an irony of fate that having provided this appeal, the same Department should further try to insist on tutoring him how to make an assessment. And the interference does not end at the level of the junior Income-tax Officer. Whenever an Appellate Assistant Commissioner gives a reduction in a big case, down comes the Inspecting Assistant Commissioner and the Commissioner, and they file an appeal to the Appellate Tribunal. Fortunately, experience has shown that in most of these appeals the decision of the Appellate Assistant Commissioner is upheld by the Tribunal, but the effect of this action itself is demoralising to the Appellate Assistant Commissioner, and this one of the fruitless causes of delay in appellate disposals. We think that in order to put a curb on the indiscriminate use of appeals by the Commissioner, a list should be maintained of such appeals filed by the Commissioner by the Central Board of Revenue and where the numbers is large of unsuccessful appeals against the decision given by the Appellate Assistant Commissioner, a blank mark should be put by the Central Board of Revenue against the Commissioner and the Inspecting Commissioner concerned as denoting their want of proper appreciation of facts and of law.

We have to invite attention to a suggestion we had made in our Memorandum to the effect that the public should be associated with assessment or appeal work at some suitable stage. We repeat this proposal as a measure of putting a curb on the capacity of the Income Tax Officers and indiscriminate use by the Commissioners and others of their powers to enhance assessments or to frighten the Appellate Assistant Commissioners.

(2) Another reason why the Officers are not able to their work expeditiously is that they are given insufficient training. In the U. K. Officers have to undergo a training of not less than 8 years before they are given independent work for assessment. Recently the Board of Inland Revenue appointed a Committee under the Chairmanship of Sir Eric St. John Bamford to report on the improvement of arrangements and disposal of work in the Inland Revenue Board. That Committee reported in 1950. We suggest that a similar Committee should be appointed in India to go into the correct facts regarding the method of income tax administration in this country. On first thoughts it appears, comparing the figures quoted in the report of the English Committee that the staff in India is very inadequate. The total staff of the Inland Revenue Department at the end of 1950-51 was 52,988, a net increase of 3,239 over the preceding year. The number of assessments made in 1949-50 was 27,76,950 as against about 11,00,000 and odd in India. The net income assessed in England, however, after allowing depreciation, was 2,412 million pounds and the tax was 814 million pounds. Unfortunately, we have no comparable figures for India, but we know that our figures of income and tax must be woefully lower than these. But it is not the tax but the work that counts, and so far as the work is concerned, it looks to us from these figures that in India the staff is undermanned, and no wonder, therefore, that the work is not being pushed on as expeditiously as it should.

(iii) Most Income-tax Officers in India are crowded. We think that better facilities should be given, as in business houses, for seating and reception of the assessee. Interviews should be so arranged as to leave sufficient margin of time for the Officer to complete each interview before the next comes on. It is sometimes objected to that this is not possible, because at times some parties are absent and at other times they take more time than scheduled. But these difficulties are inherent in the system, and with experience, the least that is expected of an Income-tax Officer is that he should know his assessee and the time that they are likely to take.

(iv) Nothing can be better than an attempt to secure the largest measure of agreement on facts between the assessee and the Department at the Income-tax Officer's level. It has, however, been complained to us by a number of persons who have to appear before Income-tax Officers that such agreement is often not possible as in most cases the Income-tax Officer is not his own master. We have already said that this type of restraint on the Income-tax Officer should be abolished or at least curtailed.

Question 98.—What changes would you suggest in the existing arrangements relating to—(i) issue of notices; (ii) simplification and filing of returns; (iii) levy of penalties; (iv) recovery of tax; and (v) appellate procedure and machinery, particularly with reference to administrative control over Appellate Assistant Commissioners?

(i) Notices should clearly indicate the requirements which the assessee is expected to fulfil, and they should be couched in language which the assessee can easily understand.

(ii) We have referred to the simplification and filing of returns earlier, and we have nothing more to add.

(iii) Regarding the levy of penalties, we have had to refer earlier to this question in another connection. We think that the present method of levying penalties without any graduation is wrong. Thus the same penalty is prescribed for not filing a return of income, for not being able to attend on the Income-tax Officer on a particular date, for not being able to produce the accounts required by the Income-tax Officer, and also for making deliberately a false return. We think that this clubbing together of all faults and crimes is incorrect. We think that a graduated scale of penalties according to the veniality of the offence should be prescribed.

(iv) Regarding recovery of tax, we have already given our views, and we have nothing more to add here.

(v) About appellate procedure and machinery, we have already stated how the Appellate Assistant Commissioners are being treated with scant courtesy by the Commissioners at the instance of Inspecting Assistant Commissioners. We think that this has demoralised the appellate machinery under the Income-tax Act, and we therefore agree wholeheartedly with the suggestion made by the Income-tax Investigation Commission that the Appellate Assistant Commissioners should be placed under the administrative control of the Legal Department in preference to that of a Income-tax Department.

One other point that requires to be considered in connection with appellate procedure is that sometimes the same point occurs in more than one assessment. Appellate decisions take a long time to be finalised or reached. In the meantime, other assessments have taken place. If often happens, as it has happened in the case of the Tribune Trust, that an assessee, thinking that the benefit of an appellate decision in the first year would be available to him for the subsequent year, does not file an appeal. The Income-tax Department has often taken advantage of this fact and refused to allow due relief, only on the technical ground that the appeal was not filed. We think that benefit should be given of appellate decisions for earlier years if assessments for subsequent years happen to have been made after the first decision had been taken in appeal.

Question 99.—(a) Do you think that undue delay occurs at present in the course of assessment proceedings? If so, what do you attribute this to and what are your suggestions for remedying this? (b) In order that delays of the kind mentioned above do not appreciably affect collection of a substantial portion of the tax due, should any special concessions be provided to assessee to induce them to make advance payment of tax?

(a) We do think that undue delay occurs in many cases in the case of assessment proceedings. We attribute this, as we have said before, to various causes, the principal of which is that the Income-Tax Officer is treated as only a pawn in the game of assessment, and is not given the authority which is his due under the Income-Tax Act.

(b) In order to avoid delays in the payment of tax, we have already suggested earlier that assessee should be allowed to pay the tax within a short time of the filing of the return on the basis of the return of income. Then there is also the advance payment system under Section 18A in vogue. As a result of these, we expect that the delays in recovery will be greatly reduced. No special concessions need be provided to induce the assessee to make their payments. The large arrears that are now standing against the assessee are due to economic conditions and not entirely to the unwillingness of the assessee to pay. This unwillingness is apparent only in those cases in which the assessments have been too high for the purse of the assessee to bear.

We might state in conclusion, in regard to the Note at the end of Question No. 99, that, generally speaking, we are in full agreement with the views of the Income-tax Investigation Commission, and where we do not agree with them, we have already indicated our disagreement at the proper place in the above answers.

Question 100.—What, in your opinion, would be the circumstances which would justify the levy of Excess Profits Tax or special business taxes?

In our opinion, Excess Profits Tax is unjustified in peace time. We might refer again to pages 346 and 347 of the book to which we have referred earlier, viz., "Taxation and the American Economy" by Mr. Anderson. It has been mentioned at the pages quoted above that the Excess Profits Tax is not a tax for peace time, and the reasons have been given, the main reason being that the standard of income is difficult to ascertain for purposes of arriving at the excess. Another reason is that possibilities of making of high profits are few; and thirdly, the tax will kill initiative. There are, however, some things to be said in favour of the Excess Profits Tax, but we think that, for this country at any rate, Excess Profits Tax in peace time is not advisable.

Among special business taxes can be mentioned the Sales Tax and the Business Profits Tax which are being levied in this country. They are a regular feature of the States and Central Government taxation, and it is too late in the day to discuss the necessities or possibilities of such taxation.

Question 101.—What are your main reactions to the Estate Duty Bill at present before Parliament?

We do not think that the Estate Duty Bill was necessary or even advantageous to this country. It will effectually kill capital formation, and if the trends can be sensed at this early stage, it is already apparent that a good deal of cash will be carried by people in order that estate duty might leave some money with them immediately after their death for their survivors to subsist and this will mean an equal loss to capital formation for industry. In this connection, we have quoted in our Memorandum the views of Henry C. Simons as expressed by him in his book entitled "Federation Tax Reform", and we repeat them here. He says:

"The tax system should be used systematically to correct excessive economic inequality and to preclude inordinate, enduring differences amongst families or economic strata in wealth, power and opportunity. Given a proper tax base, severe progression would, I think, not seriously impair incentives if the top bracket rates were kept well below 100 per cent. Top rates probably should not exceed 80 per cent. save in War time. Even those who deplore the effect of such rates on enterprise and industry must recognise a kind of dilemma here, for whatever the proximate effects, gross and persisting inequalities of wealth are themselves obviously inimical to enterprise and industry among the beneficiaries of such inequality. Far more important, in the long view, is the threat, which such inequalities involve for our whole institutional system, for the economic freedom as a basis or indispensable complement of other liberties.

"It is easy—so easy that it seems irresponsible—to say that this problem should be dealt with by inheritance taxation. The Income-tax is a powerful instrument, needing only small and minor alterations to make it reasonable, equitable and avoidance-proof. Inheritance taxation is merely a seductive, vague nostrum, which has never been soundly implemented. Until someone indicates how to make inheritance taxation into a powerful instrument for correcting inequality, i.e., into an equitable and avoidance proof levy, we will do well to rely mainly on the Income-tax for that purpose."

Even the framers of the Act have agreed that the Estate Duty Bill was more an act of faith than a measure that is going to bring much grist to the mill of Government.

Question 102.—Would you in the matter of rates of levy differentiate between self-acquired property forming the estate of a deceased and property inherited by him?

The Estate Duty Bill which has now become the law of the land does not provide for different rates of levy for self-acquired property and property inherited by the deceased. We think, however, that such a differentiation should have been made.

THE WESTERN INDIA AUTOMOBILE ASSOCIATION, BOMBAY

COPY OF LETTER, DATED 18TH SEPTEMBER, 1953 from THE PRESIDENT OF THE ASSOCIATION TO THE SECRETARY, TAXATION ENQUIRY COMMISSION.

I am directed by my Committee to thank you for sending us two copies of your Commission's Questionnaire and giving us an opportunity to express our views in regard to the taxation of motor vehicles. The relevant questions applicable to motor vehicle taxation are those given under the heading "Taxes on Motor and other Vehicles" in Part V of the Questionnaire and the answers given herein are mainly confined to them. My Committee are aware there are a few questions under the other headings as well which may be said to have some bearing on the subject but as the problem in its essence is being dealt with here, they are not giving answers to such questions separately.

Before dealing with the questions mentioned above with which this Association is concerned most, my Committee desire to submit certain fundamental considerations, which, in their view, should govern the taxation of motor vehicles and the commodities required for their maintenance. In the first place, my Committee are of the opinion that there must be a greater degree of co-ordination as between the Central, State and Local Tax Authorities so that the taxation of motor vehicles is based on a common transport policy rather than on the revenue requirements of each. In other words, no single authority should be invested with powers to tax motor vehicles unless it is in consonance with the accepted over-all policy which is laid down. The bane of the existing system is that the motor vehicle is considered a legitimate source of revenue by each and every authority and, in its eagerness to raise as much money out of this source as possible, each follows its own uncorrelated inclinations which not only result in a very heavy burden being placed on motor transport but also prove to be highly detrimental to its progress and growth. Indeed, the net result of all these uncoordinated taxation is to bar its rapid development, thereby putting a spoke on the country's advancement. It is therefore highly necessary that Government should examine, as early as possible, whether it is in the interest of the country that there should be so many authorities claiming the right to levy taxes on motor vehicles. Alternatively, the tax-levying powers should be subject to an over-all policy to be laid down by the Central Government which would curb the prevalent tendency to impose taxes irrespective of what are already being collected and indifferent to the commodity's tax-bearing capacity. My Committee consider it strange that while in the matter of rail, air and sea transport there is centralisation of control with its manifold advantages, in respect of road transport there is discrimination, being at the mercy of three different bodies with all its disadvantages.

Secondly, my Committee are opposed to the existing multiplicity of taxes which are levied by different authorities at various stages of the use and ownership of the automobile. Apart from the hardship and trouble which this involves, the collection process is troublesome and expensive both to the authorities as well as to the motorists. My Committee are in favour of a simplified system of taxation which, while ensuring a reasonable revenue, would also take into account the ability to pay and the importance of motor transport in the economy of the country. The encouragement of such a system which will do away with the present complicated tax structure will encourage the growth of motor transport and contribute to a steady increase in revenue from this source, offsetting, in due course, any loss which the switchover might entail. The consolidation of the taxes is likely to evoke opposition from those from whom the tax-collecting powers are taken away but this is a crying reform which is long overdue and my Committee urge it should be pushed through as early as possible.

Thirdly, my Committee consider that the existing tax incidence is excessive and must be reduced, if cheap and quick road transport facilities are to be available to the public. The development of motor transport is vital for the country's progress but its popularity and use are in direct proportion to its cost. That the existing level of taxation is acting as a hindrance to the growth of this type of transport is easily borne out if we compare the number of automobiles on the road in India with similar statistics of other countries. According to one calculation, we have only 250 vehicles per thousand square miles, whereas Ceylon has 1,300, Malaya 850, Philippines 650, France 7,000 and U.S.A. 12,000. It is obvious that the heavy burden of taxation is acting as a deterrent to the increase in the number of automobiles and their widespread use. The crippling effect which the present incidence of taxation is having on motor transport has been recognised by the Post-War Technical Sub-Committee on

Motor Transport (1943), the Motor Vehicle Taxation Enquiry Committee (1950) and the Tariff Commission (1953), and my Committee express the hope that this aspect would receive your careful consideration and, convinced of the injustice meted out, you will advocate a lowering of the tax level. Incidentally, it will not also be out of place for Government to examine the price structure of petrol and see if it cannot be reduced, to afford some relief to motor vehicles.

My Committee are of the opinion that besides the lowering of the tax burden, it is also necessary to establish uniformity, both in the assessment and the rates of taxation as between the different States. Uniformity of the tax rules will contribute to inter-State trade and the establishment of welcome reciprocity as between the different States. In the same way, as a driving licence issued in one State is recognised during its validity by all the other States, a vehicle taxed in one State should be allowed circulation for the period taxed in the other States without the payment of further taxes. At present, there is no reciprocity as between some of the States. A glaring instance is Mysore which requires that a motorist visiting or passing through the State must take out a Short-Term licence. The want of reciprocity strikes at the root of free travel and discourages touring by road. My Committee feel that the Central Government should ensure that the principle of reciprocity is recognised by the States; otherwise there will be double taxation which will work to the disadvantage of motor transport. In the same way as the railways have uniform rates for the transport of goods and passengers which do not vary from State to State, even so the taxation of motor vehicles in the different States should be on identical lines.

Having made these observations, my Committee now take up, one-by-one, the specific questions raised by you, and their answers in respect thereof are as follows:—

Question 168.—At present, taxes on motor vehicles are collected by three different authorities, Central, State and Local. There is no uniformity either in the basis of assessment or in the methods of collection or in the quantum of taxation as between State and State. The Motor Vehicle Taxation Enquiry Committee has calculated that the annual tax incidence on a light passenger car ranges from Rs. 755 in Delhi to Rs. 924 in Madras and Rs. 953 in Bombay. The total incidence of tax has since gone up, a glaring instance being Bombay which, during the past year, raised the vehicle tax for cars by 50 per cent. and the Petrol Sales Tax by 300 per cent. How far the action of the State Governments in pursuing their own tax policies has the approval or backing of the Central Government is not known, but coming so soon after the publication of the Government-appointed Taxation Enquiry Committee, it has left the impression that the States and the Centre are pulling in different directions instead of following a common policy. My Committee are of the opinion that the starting-point of motor vehicle taxation should be the enunciation of the basic principles which should govern the treatment of motor vehicle transport by the authorities. The formulation of these principles should be supplemented by the framing of a common taxation code to be issued for the guidance of the State Governments. These, we feel, are essential pre-requisites for the application of a revised tax system and unless these are satisfied, by Committee regret it would be difficult to bring about any marked change in the existing conditions. Of course, the States are jealous of their powers and, in the normal course, they are unlikely to surrender them in favour of the Centre; but even if they agree to exercise them with due regard to the accepted over-all requirements of the country, that would be a definite progress, giving an entirely new orientation to the existing system.

Examining the present tax structure, my Committee, while in favour of a consolidated tax, recognise that it may not be possible to do away with some items of taxation like the Import Duty on vehicles, accessories and petrol, Sales Tax and the Vehicle Tax. At the same time, they are of the opinion that the main item of taxation should be the fuel on which the automobile runs. The fuel or petrol tax is easy to collect as it is merged in the price, and from the total petrol consumption one can work out the accruing revenue to Government. Apart from these advantages, it taxes the vehicle only to the extent to which wear-and-tear are caused to the roads. On the basis of fuel consumption, the small vehicle will pay less while the big or heavy vehicle which causes greater damage to the roads will pay more. This tax can be collected by the Centre as they are even now doing

and the proceeds ear-marked to the States, according to their respective petrol consumption. While the fuel tax will form the main item of taxation, the Import Duty and the Sales Tax must perforce remain, as no distinction can be made between this and other commodities all of which are subject to the duty and the tax. Next to the fuel tax, the State vehicle tax must form an important source of revenue. This tax in the case of motor cars should be levied on the basis of the unladen weight of the vehicles. Apart from these items, my Committee are in favour of the abolition of all other taxes on motor transport barring, of course, any special fees charged for specific services rendered. This would also result in a saving in the collection expenses which are at present incurred by the local bodies.

The question now arises what should be extent of taxes in respect of these various items which are to supplant all the other taxes levied at present. It is difficult to prescribe off-hand any particular scale but the object should be to raise sufficient revenue not only to provide, maintain, improve and extend the roads but also to contribute a reasonable margin to the general revenue which, in any case, should not exceed the contribution made by the railways. After deducting the portion to be credited to the general revenue, the balance of yield should be apportioned between the Centre and the States, in proportion to their respective road obligations and the latter, in their turn, should compensate the local bodies for the loss of revenue caused by the withdrawal of local taxes and other levies.

My Committee, as already stated above, consider the introduction of a consolidated tax as a desideratum but this is not feasible as in the present context of things, it is impossible to do away with either the Central Duties or the State Vehicle Tax. My Committee have explained that when we are levying Import Duties on all imported goods, we cannot make an exception in the case of motor vehicles and their accessories nor can the State Governments forego vehicle tax which enables them to licence and keep a check on the vehicles. My Committee feel that the object underlying the proposal for a consolidated tax can be served by making the fuel tax the main tax and the vehicle and other taxes, subsidiary ones.

Question No. 169.—My Committee are of the opinion that the entire proceeds from the taxation of motor vehicles should be utilised for the construction and maintenance of roads, leaving a margin towards the general revenue, not exceeding the contribution of the railways.

It has been recommended by the Motor Vehicle Taxation Enquiry Committee that the proceeds of the taxes collected by the Centre should be credited to the Central Road Fund while the revenue from the vehicle tax should be credited to the State's Road Fund. Besides, the allocations to States from the proceeds from the petrol taxes collected by the Centre should be made into each State's Road Fund. The work on the national highways should be financed from the Central Road Fund while the road programmes of the States should be attended to from out of the money in the State's Road Fund. Unless the major portion of the revenue accruing from taxation is set apart for road development, the country cannot expect to achieve any substantial improvement either in the construction of new roads or in the up-keep of those available. It is well-known that our country, although it leads in the matter of taxation of motor vehicles, is far behind other advanced nations in the matter of roads. This is because sufficient funds are not available to be spent on roads; the major portion of the revenue from taxes accrues to the Centre but the major responsibility of road development is on the States. In view of this anomalous position, it is essential that steps should be taken to augment the funds available to the States for road development and this is best done by ensuring that larger allocations are available to them from the petrol revenue to be spent on roads.

Question No. 170.—My Committee welcome in general, the recommendations of the Motor Vehicle Taxation Enquiry Committee, 1950, as they envisage a new deal for motor transport. The main recommendations of the Taxation Enquiry Committee are the following:—

1. Central Taxes—

- (a) The Import-Excise Duty on petrol to remain as at present.
- (b) Import Duties on motor vehicles, parts and accessories to be reduced to the pre-1950 level.

2. States' Taxes—

- (a) A central surcharge of six annas per gallon on motor spirit be levied in place of the Sales Tax on petrol.

- (b) The vehicle tax to be levied not exceeding the ceiling rates specified.
- (c) Sales Taxes on Motor vehicles and accessories to be reduced to non-luxury rates.
- (d) The fees collected to approximate to the cost of the services rendered.

3. Local Taxes—

- (a) Wheel taxes on motor vehicles, octrois, terminal taxes and other local levies to be abolished.
- (b) A road cess on land revenue to be levied by way of contribution from rural bullock carts to the Road Bill. Professional bullock carts and other road users to be taxed.
- (c) Municipal roads in general give access to property and can regularly be paid for from property taxes.

4. The share of the Central petrol tax credited to the Central Road Fund to be raised from 2½ annas to 7 annas, the increase being intended to match on a 75 per cent. ratio the States' fuel tax.

5. A vehicle tax paid in any one State to be valid throughout India.

The cumulative effect of the various recommendations, according to the Dalal Committee, is to reduce the annual tax incidence on private cars and other vehicles albeit in a small way. The relief promised is welcome but we feel that if the fuel is to form the main item of tax, there should be a lowering of the level of the vehicle tax, say at least by 25 per cent. of the ceiling laid down. The loss in the revenue will be made up by the increased revenue accruing from the petrol tax at the enhanced rates. In any case, the main consideration which should weigh with the authorities is the money required for the maintenance and development of the roads and if the bulk of the proceeds from the taxes are used for this objective, there is no reason to fear that a reduction in the tax will affect the roads adversely.

Further, as has been pointed out by the Taxation Enquiry Committee, it must not be forgotten that motor vehicle traffic is not the only traffic which uses the roads and it is therefore unfair that it should be made to foot the entire Bill. Roads are national assets, both in peace and war, and it would be a reasonable charge if a portion of their cost is debited to the general revenue. In view of the divided obligations, the responsibility for roads should be shared in a reasonable proportion between the Government, the motor transport and the other road users and if this is done, the proceeds from the motor vehicle taxation will be found more than sufficient to pay for their share of road use. Subject to these observations, my Committee are in general agreement with the Taxation Enquiry Committee's Report and hope the proposals made would be implemented soon.

Question No. 171.—My Committee consider that as the benefit of the roads is available to all, it would be unfair to throw the burden of their cost and up-keep entirely on motorists. In fact, the iron-tired bullock carts are extensively in vogue and they are still the main means of transport of goods and passengers, especially in the rural parts. They act as connecting links between the rural and urban areas and are handmaids of agriculture and industrial raw materials. The extent of the damage which these vehicles cause to the roads is not insignificant and my Committee therefore feel that such traffic should also be made to contribute to the Road Bill.

The Motor Vehicle Taxation Enquiry Committee in their report have examined this aspect and suggested that a road cess on land revenue of one anna in the rupee should be collected in all States and the proceeds credited to the States' Road Fund for distribution to local bodies, to be expended on roads, the cess being an indirect tax on the rural cart. They have further suggested that a tax of at least Rs. 60 per annum should be levied on professional bullock cart operators. Another point made by the Taxation Enquiry Committee is that since roads contribute to an increase in the value of the property, the local bodies would be justified in increasing the property taxes and the additional proceeds could be considered as legitimate compensation for the loss of revenue entailed by the abolition of the local levies. It is also stated that as roads are beneficial to the country at large, the general tax-payer should bear a portion of their expenses; in other words, a part of the Road Bill equivalent to 1/3rd thereof should be footed from the general revenues. My Committee agree with the foregoing suggestions of the Motor Vehicle Taxation Enquiry Committee and urge that steps should be taken on the lines indicated.

MADRAS

ASSOCIATION OF MUTUAL LIFE OFFICES IN INDIA

REPLIES TO QUESTIONNAIRE OF TAXATION ENQUIRY COMMISSION.

PART II.—DIRECT TAXES.

INCOME-TAX.

Income.

Question 47.—Does the definition of "Income" (Section 2(6C)) require any modification?

Yes. The definition has to be modified, rather rectified, so that the valuation surplus of Mutual Insurance Associations may be excluded from this definition. In this connection, we would like to point out to you the following from an article appearing in "Commerce", Bombay, dated the 26th June, 1948, by Sri R. K. Dalal, B.COM., F.S.A.A., R.A., for your kind consideration:

"Are the profits of a mutual insurance company liable to tax, notwithstanding the amendment of the Act in 1939? 'Income' under section 2(6C) includes, 'profits of any business of insurance carried on by mutual insurance association computed in accordance with Rule 9 of the Schedule.' Therefore, it means that profits of a mutual insurance company are included in the term 'income'. It does not deem, therefore, anything which in the ordinary connotation of the word is not profit. If it did it will have to create a fiction of law..... Therefore, so far as mutual companies are concerned, no fiction of law is created by Section 2(6C) or any other section..... The fact that under the revised definition of 'income' in Section 2(6C), profits of insurance company are included does not lead to the conclusion that 'profits which are not profits under the Act' are, therefore, liable to be taxed..... It is submitted similarly that the fact of the mere amendment of Section 2(6C) does not create a liability which previously under the law was absent."

Question 60.—Should any liberalisation be made in the present limits of exemption from tax of life insurance premia and contributions to provident funds?

Yes. The present limits of exempting from income-tax 1/6 of one's income subject to a maximum of Rs. 6,000 in the case of an individual and Rs. 12,000 in the case of a Joint Hindu family, should be raised to 1/5th, Rs. 10,000 and Rs. 20,000 respectively in view of the present low value of the Rupee and the high cost of living. When the previous enactment fixing these limits was passed, the value of the Rupee was much higher and the cost of living was much lower. So the limits prescribed in those days cannot be said to be quite suitable for the present days. The above suggested increased limit of exemption will also encourage further habits of thrift and insurance among the public, thus making available increased funds for investment in Government Securities through Insurance Companies and Provident Funds.

Question 82.—Do you think that any special provisions are necessary for the assessment of—

(a) bank; and

(b) investment companies?

Do existing rules relating to assessment of insurance companies, especially mutual insurance associations, require any change? If so, in what respect?

Yes. Till 1939 Mutual Insurance companies were not taxed in India on the basis of profits, apparently in accordance with a decision of the House of Lords in 'Styles' case. Indian Income-tax law had taken a lead from the English law and therefore, upto 1939 the Indian Income-tax law did not tax the profits of Mutual Life Insurance Companies just like the English Income-tax law. Subsequently the British Parliament tried to rope in Mutual Insurance Companies for purposes of taxing; but these efforts were nullified by a decision of the House of Lords in 'Inland Revenue Commissioners vs. Ayrshire Employers' Mutual Insurance Ltd. In effect, the House of Lords emphasised the distinction between 'surplus' and 'profits' and held that in the case of Mutual Insurers, "the surplus was not profit within the meaning of the Income tax Act but merely representing the extent to which the contributions of those participating in the scheme had provided in experience to have been more than what was necessary to meet their liabilities. The balance or surplus was the contributors' own money and returnable to them." Referring to section 31(1) of the Finance Act, 1933 of England, Lord MacMillan said that the hypothesis on which the section rested was wrong and that the "Legislature has plainly misfired." Even the intended purpose of the Legislation was characterised by him as "not the meritorious object of preventing evasion of taxation but the less laudable design of subjecting to tax as profit what the law has consistently and emphatically declared not to be profits."

Indian law also recognised this difference until 1939, when perhaps owing to the need to increase all sources of taxation during the war, an amendment, including Mutual Companies and Co-operative Insurance Societies within the scope of taxation was brought in by an alien Government. The position as regards the Co-operative Insurance Societies was altered in consequence of a decision of the Bombay High Court. With regard to the position of Mutual Companies, the Bombay High Court, in another suit observed that it was "not a very laudable intention of the Legislature to have taxed Mutual Companies". But the Mutual Companies continue to suffer from the disability evidently for want of proper representation of the above points.

Therefore, the point that our Association would urge before the Taxation Enquiry Commission appointed by the Government is that these Associations (Mutual Insurers) though registered under the Companies Act are not in fact companies trading for profit but Associations, the members of which have joined together to help one another mutually for the purpose of Insurance. It is for this basic reason that Co-operative Insurance Societies not trading with other than members are exempted from income-tax (vide Part II of exemptions notified under Sec. 60 of the Income-tax Act 1952 by the Central Government).

The special position of Mutual Associations in this matter has also been recognised in the Insurance Act; during the passage of that Act the opinion was expressed that Mutualisation was the first step towards nationalisation implying the recognising the aspect that such Associations were not run for profits. Further, the members of the Mutual Insurance Societies belong overwhelmingly to the classes who are themselves not liable to income-tax on their own income. The relief given from income-tax for insurance premiums (Section 15 of the Income-tax Act) is in their case illusory. On the other hand their small savings through insurance are taxed indirectly by the taxation of the surplus of Mutual Insurance Companies. If these investments took any other shape involving a deduction at the source, they would be entitled to a refund. Such taxation therefore, we respectfully submit, tends to discourage the habit of insurance, which should be fostered in our country in the interest of the lower income groups.

We also respectfully submit that neither basic premiums nor the specific bonus loadings in the case of with-profits policies are an accurate measure of the cost of insurance but only estimates with a margin of safety. Further, the specific bonus loadings are not those which are expected to emerge in future valuations. If this were so, with-profits policies would cease to be attractive. It is our contention that the bonuses declared by Mutual Societies are steady and gradual releases of premiums collected in excess of the necessary amount as shown by the subsequent actual experience. Such returns of excess payment should not be treated as profits liable to tax. The position of Mutual Companies in this respect is somewhat different from that of proprietary companies. The quantum of bonus given by the proprietary companies is dictated by business considerations of attracting an increasing number of customers and thereby increasing their trade profits and not by their nature and constitution. The Mutual Societies by their very nature cannot make any profits, since they trade with no outsider and as in Co-operative Insurance Societies any excess charge made is returned to the members in the shape of reversionary bonuses. We may also be permitted to point out that this position is recognised under English and American law where mutual societies are exempt from taxation.

May we also respectfully submit that the present taxation of Mutual Insurance Companies is an anomalous attempt? All the reasons that lead to the exemption of Co-operative Insurance Societies from tax also apply to Mutual Companies. We therefore urge that this anomalous position may be rectified and that the Mutual Companies be exempted from taxation in the same way and to the same extent as the Co-operative Insurance Societies.

DEATH DUTIES.

Question 101.—What are your main reactions to the Estate Duty Bill at present before parliament?

It is a salutary measure, but we have to point out a few things which are quite important about this Estate Duty Bill:—(1) Any law that comes in the way of raising the average insurance per head in India, which is at present as low as Rs. 20, is really not a healthy legislation for the time being; (2) Any legislation that discourages insurance among the rich or the poor will adversely affect the growth of the nation itself; (3) Certain sections of the Estate Duty Bill will in effect neutralise some of the provisions of the Insurance Act like those on assignments and nominations and this is not at all desirable; (4) Besides this, we have to suggest that the limit of exemption to Life Insurance should be raised to a decent figure from the present minimum of Rs. 5,000 in the Estate Duty Bill. That is to say, irrespective of the status of the deceased person, however high or low it may be, a decent amount of insurance should be exempted from the levy of Estate Duty.

102. *Would you in the matter of rates of levy differentiate between self-acquired property forming the estate of a deceased and property inherited by him?*

No.

PART V.—OTHER TAXES (CENTRAL AND STATE).

STAMP DUTIES AND COURT-FEES:

162. *Under the Constitution—*

- (1) *the Union is empowered to fix the rates of stamp duties in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts and*
- (2) *the States are empowered to fix the rates of all other stamp duties.*

As regards both (1) and (2), have you any suggestions to make for the levy of a stamp duty where it is not already levied, or for an increase or decrease of the present rates where a stamp duty already exists? Please give reasons for your suggestions. Are there any general principles which you would propose for adoption in regard to the fixation of rates of stamp duties?

As regards (2), since the rates vary from State to State, what degree of uniformity do you consider desirable and feasible, and how do you propose to achieve it?

If possible, please estimate the net effect of your proposals on the revenues of States.

As regards (1) no attempt should be made to levy stamp duty on cheques. The present stamp duty on insurance policies is sufficiently high. Therefore it should not be enhanced in any case. Regarding stamp duty on receipts, temporary receipts issued by or on behalf of insurance companies, in respect of which an official stamped receipt will follow within 30 days of the issue of temporary receipts, should be exempted from the levy of stamp duty. In the United States of America, all receipts are exempted from stamp duty as may be noted from the following extract from a letter received from Life Office Management Association of America:—

“In the first place, it has never been the practice in America to require revenue stamps to be placed on receipts in order to validate them. This seems to be one source of income which our ambitious taxing bodies have overlooked. Perhaps it is due to the stigma which has always been placed on a stamp tax in this country. If you are familiar with American history, you will recall that it was the Stamp Act imposed upon the Colonists in the early Seventeenth Century that became the spark which set off the American Revolution. We in this country, to an ever increasing degree, are viewing cancelled checks (cheques) or money order receipts as a substitute for a formal receipt. As a matter of fact, a goodly portion of our Life Companies today will issue a premium receipt only upon specific request of the policyholder. The cancelled check (cheque) is accepted by the great majority of our policyholders as a receipt which carries that status in court actions.”

Further, exempting temporary receipts issued by or on behalf of Insurance Companies which are to be followed by official stamped receipts within 30 days, is no relaxation of Law involving any loss of revenue. The increase or decrease of revenue from this exemption is absolutely nil. Therefore this exemption can be safely granted by the Central Government.

As regards (2), it becomes very difficult for inter-state negotiation of Mercantile instruments when their stamp duty varies from State to State. Therefore the States should see that all Mercantile instruments are charged a uniform rate of stamp duty without fail and the Centre should advise the concerned States in this regard. If the Centre brings to bear its influence on all the States in

this regard, there is no reason why the required measure of uniformity in the rates of stamp duty to be charged on Mercantile instruments cannot be achieved throughout the Republic of India. This measure also costs almost nothing to any Government whereas it gives immense relief to the mercantile community throughout the country. No State should be allowed under any circumstances or for any reasons of exigency or otherwise to deviate from this very healthy and essential practice.

Copy of Letter dated 13th June 1953, from the President, Association of Mutual Life Offices in India, to the Chairman, Taxation Enquiry Commission.

In the letter No. F. 51(5) I.T./53, dated 12th May, 1953 of the Ministry of Finance, (Revenue Division) Government of India, there was a direction to us to the effect that we may, if we so desire, place our views before the Taxation Enquiry Commission. In pursuance of this direction we wish to place in your hands this Memorandum of Mutual Life Offices for exempting them from Income-tax on the same basis as the Co-operative Insurance Societies.

The Income-tax Investigation Commission in their report to the Government of India had said, “The Government must make up its mind whether it is going to treat Mutual Insurance transactions as transactions yielding profit.” Till 1939, Mutual Insurance Companies were not taxed in India on the basis of profits, apparently in accordance with a decision of the House of Lords in *Styles’ case*.

Indian Income-tax law had taken a lead from the English law and therefore, upto 1939 the Indian Income-tax law did not tax the profits of Mutual Life Insurance Companies just like the English Income-tax law. Subsequently the British Parliament tried to rope in Mutual Insurance Companies for purposes of taxing; but these efforts were nullified by a decision of the House of Lords in *Inland Revenue Commissioners vs. Ayrshire Employers’ Mutual Insurance Ltd.* In effect, the House of Lords emphasised the distinction between ‘surplus’ and ‘profits’ and held that in the case of Mutual Insurers, “the surplus was not profit within the meaning of the Income-tax Act but merely representing the extent to which the contributions of those participating in the scheme had provided in experience to have been more than what was necessary to meet their liabilities. The balance or surplus was the contributors’ own money and returnable to them.” Referring to Section 31(1) of the Finance Act, 1933 of England, Lord MacMillan said that the hypothesis on which the section rested was wrong and that the “Legislature has plainly misfired.” Even the intended purpose of the Legislation was characterised by him as “not the meritorious object of preventing evasion of taxation but the less laudable design of subjecting to tax as profit what the law has consistently and emphatically declared not to be profits.”

Indian law also recognised this difference until 1939, when perhaps owing to the need to increase all sources of taxation during the war, an amendment, including Mutual Companies and Co-operative Insurance Societies within the scope of taxation was brought in by an alien Government. The position as regards the Co-operative Insurance Societies was altered in consequence of a decision of the Bombay High Court. With regard to the position of Mutual Companies, the Bombay High Court, in another suit, observed that it was “not a very laudable intention of the Legislature to have taxed Mutual Companies”. But the law in India, is so framed as to make the question of taxation of Mutual Companies a bit safe for the Government and so they have successfully continued to tax them since 1940. Hence the Mutual Companies continue to suffer a disability evidently for want of proper representation of the above points.

Therefore, the point that our Association would urge before the Taxation Enquiry Commission appointed by the Government is that these Associations (Mutual Insurers) though registered under the Companies Act are not in fact companies trading for profit but Associations, the members of which have joined together to help one another mutually for the purpose of Insurance. It is for this basic reason that Co-operative Insurance Societies not trading with other than members are exempted from income-tax (vide Part II of exemptions notified under Sec. 60 of the Income-tax Act 1952 by the Central Government).

The special position of Mutual Associations in this matter has also been recognised in the Insurance Act; during the passage of that Act the opinion was expressed that Mutualisation was the first step towards nationalisation implying and recognising that aspect as such Associations were not run for profits. Further, the members of the Mutual Insurance Societies belong overwhelmingly to the classes who are themselves not liable to income-tax on their own income. The relief given from income-tax for insurance premiums (Section 15 of the Income-tax Act) is in their case illusory. On the other hand their small savings through insurance are taxed indirectly

by the taxation of the surplus of Mutual Insurance Companies. If these investments took any other shape involving a deduction at the source, they would be entitled to a refund. Such taxation therefore, we respectfully submit, tends to discourage the habit of insurance, which should be fostered in our country in the interest of the lower income groups.

We also respectfully submit that neither basic premiums nor the specific bonus loadings in the case of with-profits policies are an accurate measure of the cost of insurance but only estimates with a margin of safety. Further, the specific bonus loadings are not those which are expected to emerge in future valuations. If this were so, with-profits policies would cease to be attractive. It is our contention that the bonuses declared by Mutual Societies are steady and gradual releases of premiums collected in excess of the necessary amount as shown by the subsequent actual experience. Such returns of excess payment should not be treated as profits liable to tax. The position of Mutual Companies in this respect is somewhat different from that of proprietary companies. The quantum of bonus given by the proprietary companies is dictated by business considerations of attracting an increasing number of customers and thereby increasing their trade profits and not by their nature and constitution. The Mutual Societies by their very nature cannot make any profits, since they trade with no outsider and as in Co-operative Insurance Societies any excess charge made is returned to the members in the shape of reversionary bonuses. We may also be permitted to point out that this position is recognised under English and American law where mutual societies are exempt from taxation.

May we also respectfully submit that the present taxation of Mutual Insurance Companies is an anomalous attempt? All the reasons that lead to the exemption of Co-operative Insurance Societies from tax also apply to Mutual Companies. We therefore urge that this anomalous position may be rectified and that the Mutual Companies be exempted from taxation in the same way and to the same extent as the Co-operative Insurance Societies.

SUPPLEMENTARY REPLY TO QUESTIONNAIRE OF TAXATION ENQUIRY COMMISSION.

PART II.—DIRECT TAXES.

Income-tax.

INCOME.

Question 82.—Do you think that any special provisions are necessary for the assessment of—

- (a) Bank; and
- (b) Investment Companies?

Do existing rules relating to assessment of Insurance Companies, especially Mutual Insurance Associations, require any change? if so, in what respect?

Answer (Supplement to that already submitted).

We bring to your kind notice, the fact that in Canada after much litigation, the Supreme Court of the country has finally declared the practice of assessing Mutual Companies to income-tax as illegal on the ground that in a true Mutual Company there is no gain or profit. In this connection we wish to reproduce herebelow the news item that appeared in the "Spectator" of October, 1953.

THE SPECTATOR—October 1953.

CANADA: TAXING MUTUALS

"After much litigation, The Supreme Court of Canada has finally settled the question of taxation for income tax purposes of the reserve fund of a mutual company.

When the Stanley Mutual Fire Insurance Company was assessed under the income tax act on the surplus arising after payment of losses and expenses, it appealed to the Income Tax Appeal Board, contending that, being a true mutual company, it did not have any profit or gain. The Board upheld this contention and allowed the appeal.

The Government then appealed this decision to the Exchequer Court. This Court allowed the Government's appeal, on the ground that as there was no complete identity between the contributing members and the participation in the surplus or reserve funds, such funds are profits of the company.

The Company appealed this decision to the Supreme Court of Canada. This Court allowed the appeal of the

company for the following reasons: 1. The business of the company is properly described as a Mutual insurer. 2. Since it is the company that incurs the obligations to the members by issuing policies of insurance, of necessity the reserve fund must be its property as its whole purpose is that it may be resorted to in satisfaction of the company's liabilities. 3. The fund is accumulated as directed by statute, not in pursuance of a profit-making enterprise but in furtherance of a mutual insurance plan. 4. It is clear that on the windingup of the company, the surplus, if any, remaining after payment of the liabilities, would be returned to the members of the company."

The above is only one more proof or argument in favour of our contention that Mutual Companies should be exempted from income-tax just as Co-operative Societies.

Copy of letter dated 12th December, addressed to the Chairman, Taxation Enquiry Commission.

"Further to our last representation, dated 4th September 1953 to you, we desire to place a few additional factual arguments before you in support of the case of Mutual Life Offices, that is, for exempting them from income tax on the same basis as Co-operative Insurance Societies.

The Mutual Insurance Companies have no shareholders. They belong to policyholders only and their income is derived from its own members who are no other than the policyholders. Therefore Mutual Insurance Companies satisfy the principle of Mutual Co-operation in toto. It therefore follows that the income derived from the excess contributions of the policyholders cannot be treated as profits.

There is an attempt to confuse the above principle and idea by splitting up the single group of members of a Mutual Insurance Company into two viz., non-participating and participating policyholders. This way of approach to the subject is neither rational nor logical because among Co-operative Insurance Societies also both these groups of policyholders exist. But still they are exempt from income-tax simply on the principle of Mutuality and Co-operation. In other words, Co-operative Insurance Societies are exempt from income-tax because the Societies belong to their members. The participating policyholders have no proprietary interest in the Company as shareholders in a proprietary Company. This is the essential difference between a Shareholders' Company and a Mutual Company. The income of the Societies is derived from its members and none else. So, in Co-operative Insurance Societies no distinction has been made on the basis of non-participating and participating policyholders. The guiding principle or the measuring rod is that the Society belongs to its members. The same principle is to be applied to Mutual Insurance Companies too.

There are a number of legal decisions in the English Courts dealing with profits of Mutual Offices. These decisions hold that a Mutual Office do not make taxable profits. There is another case, namely, *Inland Revenue v. South West Lancashire Coal Owners Association Ltd.*, in which it was held that although a Company could make a profit from trading with its members as customers, where, as in the New York Life case, money was simply collected from one set of people and handed back to them as their right in the character of the people who had paid it and not in the character of shareholders, there was no profit (the necessary condition being that the interest in the money did not go beyond the people who had subscribed it or the class of people who had subscribed it). It can be easily discerned that the whole of the profits of the life assurance business (including annuity business) of a Mutual Insurance Company should be regarded as reserved for policyholders and annuitants. Any non-profit business which forms part of the total life assurance business cannot be rendered chargeable to tax because the whole of such business is one unit for income-tax purposes.

In connection with the several representations made by our Association, I have to state that a stage has now come where personal clarification and discussion between the members of the Taxation Enquiry Commission and the representatives of this Association of Mutual Life Offices in India is necessary. So will you kindly give us an appointment for an interview between our representatives and your members early? On hearing from you in the matter, we shall send our representative or representatives to clarify the issue further."

UNITED PLANTERS' ASSOCIATION OF SOUTHERN INDIA, COONOR

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

The Association agrees with the Commission's recommendation that we should confine ourselves to questions that are of direct interest and importance to us and not the Questionnaire as a whole.

We are of the opinion that the plantation industry is overburdened with a variety of rates, taxes, cesses and Governmental levies, which have to be provided out of revenue, while at the same time any expansion of the industry or rehabilitation or provision of new amenities and services for employees has to be provided from the same source. For example, in the case of tea in the State of Madras, these taxes and cesses include:

1. Taxes based on Income.

(a) Central Government

Income-tax on 40 per cent. of income
4 as. in the Rupee.

Super tax for companies

2 as. 9 ps. to 4 as. 9 ps. per Rupee.

Surcharge

5 per cent. on income-tax.

(b) Local

Profession tax payable to Municipalities
Rs. 125 per half year.

Profession tax and property tax payable to Panchayats..... At rates ranging between 1 to 10 per cent. of annual letting value.

2. Taxes based on Crop.

(a) Central Government

Excise Duty . . . 3 as. per lb. on package teas
and 1 anna per lb. on bulk teas.

Or Export duty . . . 4 as. per lb.

(b) Central Tea Board

Cess . . . Rs. 2 per 100 lbs.

(c) Indian Tea Licensing Committee

Licensing fees . . as. 15 per 1000 lbs.

3. Taxes based on Purchases and Sales.

(a) Government of Madras

Sales Tax . . . 1½ per cent. on turnover

4. Taxes based on Acreage.

(a) Government of Madras

Land taxes . . . Rs. 2-4-6 per acre.

(b) Municipalities

Land taxes . . . at 8½ per cent. on the annual rental value of lands.

5. Miscellaneous Taxes.

(a) Local

Machinery taxes, factory taxes, house taxes, and education cess paid to Panchayats at various rates.

In the States of Travancore-Cochin and Coorg, Agricultural Income-tax is also levied on plantation crops.

Except for income-tax, the above cesses and taxes have to be paid sometimes out of accumulated reserves or even by over-draft, even though the industry is making a loss.

We are of the opinion that the present economic policy will cripple the country. New capital must be found to start new industries with a view to expanding the resources of the country thus providing more employment. To encourage new capital and to encourage existing industries to expand, it is essential that direct taxation should be reduced as much as possible. The planting industry is an example of an enterprise which has ploughed back its profits in order to expand itself. The expansion is now impossible as a result of the unconscionably heavy burden of taxation the industry has been called upon to bear in spite of the fact that some units in the industry are running at a loss. People should be allowed to save so that they might invest in industry. If they are not allowed to save, there will be no incentive for enterprise or investment and avenues for employment will be reduced rather than expanded.

To mention only one instance, a company owning 26,000 acres of tea has been compelled to cancel its Spring manuring programme due to lack of funds. In the same company, a plot of 1,600 acres has become completely uneconomic, as a result of the present low price of tea

coupled with the high taxation. Many interests are unable to carry out their annual programme of rehabilitating 7 per cent. of their acreages with a view to increasing production.

The tax burden in the case of the plantation industry must be considered together with the enormous burdens which are statutorily placed on the industry in respect of the supply of housing, medical services and other amenities, all of which are normally the responsibility of Government or local bodies to be financed from Government or local Government revenues, and to provide which the planting industry, in common with other industries, is already taxed. In this respect the planting industry is in a very different position from other industries in India. The industry suffers double taxation in that it not only contributes to the Government and local bodies towards the cost of medical services, etc., for the people in general, but is also compelled to provide these services at its own cost to its employees. As regards housing, the industry is taxed by the local authorities on the properties which it is compelled to provide and maintain rent free for its employees.

It must be stressed that the profits made by the plantation industry in relation to the present true capital value are lower as compared with the corresponding profits on present true capital values of other industries, notwithstanding the risks inherent in a tropical agricultural industry like the plantation industry.

The following are answers to specific Questions:—

PART I.—THE TAX SYSTEM.

Question 33.—According to a recent statement made in the House of the People, foreign capital invested in the plantation industry is leaving India, probably due to the very high taxation. This investment is being replaced by Indian capital, which would otherwise have been available for capital formation in other spheres. This appears to be a definite indication that foreign investors do not consider that the planting industry in India is a sound investment due to high taxation and the ever increasing production costs. Government must offer incentives to foreign capital and not tax it out of existence.

Question 34.—Instead of increasing receipts from existing sources, it is felt that Government should take steps to cut down the cost of collecting the existing taxes.

PART II.—DIRECT TAXES.

Question 53 and 54.—We think it would be most inopportune at the present time to suggest any interference whatever in the existing division of responsibility for taxation as between the Centre and the States unless the States are given a greater share at the expense of the Centre particularly in view of the relative importance or non-importance of agriculture in the State economy of the various State Governments, and the influence which taxation must have on the problem of unemployment of agricultural workers in individual States.

Question 55.—So far as we are concerned the present law is reasonably satisfactory except in the case of Coffee, which is a highly fluctuating crop and it is desirable that in that case and in similar cases, the income should be the average over not less than 5 or 6 years.

Question 61(i).—We agree that for new assets purchased, the existing allowances are adequate, but for new assets purchased for replacements, the excess cost of replacement over original cost should be treated as revenue expenditure.

Question 62.—For purposes of agricultural income-tax it is considered essential that wasting assets like tea bushes, coffee trees, rubber trees, must be entitled to depreciation allowance to be set off against taxation. For this purpose, we suggest that the life cycle should be as follows:—

Tea . . .	40 years—2½ % depreciation annually.
Coffee . . .	40 years—2½ % depreciation annually.
Rubber . . .	40 years—2½ % depreciation annually.

Question 66(a).—No.

Question 74.—There should be no time limit for "carry-forward" of losses in the case of agricultural industries, since depreciation is already allowed to be carried forward without a time limit.

Question 75.—It is quite unfair to assess or attempt to assess an agricultural industry on the basis of previous year's profits, or to collect taxes in advance on the basis of previous year's profits, which may be totally different

from the actual year's profits due to climatic variations and agricultural hazards.

Question 83.—Every encouragement should be given to companies to plough back its savings into the business. The plantation industry is an example of how an industry could be expanded by this process. Now it is frequently impossible as there are no savings.

PART III.—COMMODITY TAXES (CENTRAL & STATE).

Question 113.—Export duties should be levied only when unconscionable profits are made. There should be a full enquiry to elucidate whether or not there is scope for export duties. Export duties on agricultural produce in the majority of countries are low and depend entirely on world supply and demand. Export duties are not part and parcel of the tax structure. Wherever export duties are levied, the first claim on the export duties should be expenditure for the promotion of long range development of the export trade, and an additional cess should not be levied for this purpose. The position should be reviewed annually by the Tariff Commission in the light of world market conditions.

Question 114.—The Tariff Commission should enquire and recommend measures to achieve greater flexibility in the rates of duties to accord with the changing conditions of export markets.

Question 116.—In view of the specialised nature of import/export trade, we do not consider it is satisfactory for the State to participate in it.

Question 117.—The selection of commodities for purposes of levying excise duties should be considered only by the Tariff Commission, in relation to the existing trade supply and demand position.

Question 118.—It is regretted that the representations to the Central Board of Revenue and the Central Tea Board have had no effect in altering the present situation whereby the Excise Department, in order to suit its own administrative convenience, levies excise duty at the cumulative rate of 7 annas a lb. on package teas, which are repacked in the hands of dealers and retailers. It has been made clear in negotiations with the Collector of Central Excise, Madras, that the only reason why this illegal rate is charged is that the Excise Department does not have sufficient officers to allow of proper supervision of repacking in smaller containers of tea which leaves the factory in packages holding less than 60 lbs. net. The tea industry is thus labouring under a special handicap at this time because it is holding very large stocks of packing materials which were purchased before the recent changes in the rates of excise duties and cannot dispose of them as it is impossible for tea to be sold in the internal market while it has to carry on the burden of paying excise duty at the rate of 7 annas a lb.

We also consider that the present excise duty of 3 annas per lb. of coffee (i.e., Rs. 21 per cwt.) is very excessive from the point of view of the consumer, as the incidence of this duty per cup is higher when compared with other beverages, which are similarly taxed.

Question 121.—It is considered that the excise department's approach to this question is quite wrong and that the levy and collection of excise duty should be re-arranged, if not to facilitate trade, at least so as not to hamper it. It is suggested that serious consideration should be given to the possibility of evolving a very much simplified system whereby producers would be assessed to excise duty on the basis of duly audited accounts, subject to such conditions as Government may deem fit to impose. It seems unreasonable that the same accounts which are accepted for the purpose of income-tax and corporation tax should not also be accepted for the purpose of excise duty, without imposing the considerable interference with the manufacturing processes and expense in collecting it which the present system involve. Practical experience of the working of the machinery of excise supervision over several years has shown that it has not prevented the loss of commodities by theft or misdemeanour, and a possible loss of a very small excise revenue is no justification for the present most expensive and obstructive provisions. It seems obvious that the cost of supervision and collection of duty far outweighs the maximum possible loss of revenue by theft or other means. It is also considered grossly unfair that the industry, which has to pay excise duty, should be called upon to pay a considerable proportion of the over-head expenses like free office accommodation and uneconomic housing facilities of such supervision and collection in addition to paying taxation to provide for this essentially Government responsibility. We suggest that some independent authority should be invited to enquire into the possibilities of introducing a more simplified system and also to enquire into the necessity and justification for continuing this expensive system which is a burden both to the State and to the industry.

Question 122.—Yes.

Question 124.—Yes. In view of the nation's obvious revenue difficulties, it would appear most desirable that Government should reintroduce this very small indirect tax.

Question 127.—While there should be uniform and preferably Central legislation on the subject of sales tax, the administration and collection of the tax should be left to the State Governments and should be State revenue.

As an alternative, sales tax may be replaced by a single point consumers' purchase tax, through Central legislation.

Question 131.—In reply to (ii), by Central legislation binding on all States.

Question 134.—Lack of uniformity between the States as regards the rates of sales tax is an inducement to illegal transactions. Under present circumstances, it is sometimes necessary to take deposits from dealers covering the possibility of as much as 3 separate contingent liabilities to pay sales tax, thereby locking up large sums of money which could otherwise be used for promoting business.

PART IV.—AGRICULTURAL INCOME-TAX, LAND REVENUE AND IRRIGATION RATES.

Question 140.—As long as India remains essentially an agricultural country, incentives must be given to agriculture; otherwise, imports particularly of foodgrains will increase to the detriment of the country's national economy and exports of commercial crops will decrease with similar adverse consequences.

PART V.—OTHER TAXES (CENTRAL AND STATES).

Question 168.—All vehicles which cause very considerable increase in expenditure on maintenance of roads should be taxed. We feel that bullock carts in particular should be called upon to pay tax unless they use rubber tyres, which would minimise the wear and tear.

Question 169.—The entire revenue from motor vehicle taxation should be applied for road maintenance and development.

Question 176.—This suggested tax would retard production and would be a brake on further industrialisation.

PART VI.—LOCAL TAXATION.

Question 185.—We consider that no local authority should be permitted to raise taxes in excess of the amount required for current estimated spendings. Plantation estates in rural areas should not be part of Panchayats, because of the fact that the estates themselves are compelled to provide all or most of the services for which the Panchayat is responsible. Such estates should come directly under the District Board. Wherever possible local taxation should be related to the service for which it is required, e.g., there should be a separate water tax, lighting tax, conservancy tax, etc., the primary responsibility for which should fall upon the user and not the non-user. Panchayats should also be subjected to maximum limits of taxation for various purposes.

Question 190.—We consider that Panchayats should be entitled to levy cesses only for certain special purposes subject to approval by the District Board and that for rural administration the bulk of the revenue required should be raised by property taxes levied by the District Board, supplemented by grants from State revenues.

Question 195.—(a) Yes. In many areas local authorities have compelled plantations to take out separate factory licences on payment of licence fees and submit factory building plans for approval even though a licence has been obtained on payment of licence fee from the State Government.

(b) Yes.

Question 199.—In reply to (ii) (a) we agree, provided it covers all the taxes.

Question 201.—Assessment for purposes of property taxes should be on the uniform basis of annual value to a hypothetical tenant.

Question 203.—There should be a scale of remission of property tax whenever a Panchayat fails to provide the amenities prescribed in the Panchayat Act and such amenities are provided by the owners themselves. When employers provide rent-free quarters for staff and labour such buildings should be wholly exempt from property tax since the owners themselves derive no income from the houses.

Question 205.—Nothing lower than the District Board or Municipality should levy property tax. The extent of power should be as laid down by the Madras State Government.

Question 220.—No. We consider that the profession tax is invidious, oppressive and discriminatory. What-

ever it may be called so long as it is based on income it is an income-tax and as it is a compulsory payment it should at least be allowed as a set off for purposes of income-tax or supertax. We consider that Rs. 250 is already excessive and should not be increased.

Copy of Letter dated 26th June 1954 from the United Planter's Association, to the Chairman, Taxation Enquiry Commission.

"You will remember that in the course of the oral evidence tendered by the Association's delegation on the 29th April 1954, you asked our delegation to furnish in writing details of the following points made by them:

(1) That the plantation industry should be allowed to retain after taxation a sufficient sum out of the profits earned to meet large commitments in respect to the implementation of labour legislation and rehabilitation of estates.

(2) That the existing ratio of 40:60 recognised by the Income-tax Department as representing the non-agricultural and agricultural portions, respectively, of the income of tea estates is purely arbitrary and is no longer fair or equitable, and that this ratio should be revised to 25:75.

So far as item (1) is concerned, the Association would point out that the plantation industry has recently been called upon to meet the following additional expenditure:—

(i) *The Plantation Labour Act, 1951.*—It is estimated that this new legislation which has been brought into force with effect from the 1st April 1954, will cost an estate of 270 acres, according to the Chairman of the Indian Tea Planters' Association of Jalpaiguri, the following:—

	Capital Expenditure			Recurring Expenditure		
	Rs.			Rs.		
Total Expenditure .	4,44,070	0	0	1,05,885	0	0
Expenditure per acre						
under tea .	1,644	11	3	392	2	8
Expenditure per worker	1,480	3	3	352	15	3
Expenditure per lb. of tea .	2	12	4	0	10	7

Although this expenditure will not be wholly incurred in the coming year, my Association estimates that our costs will increase by Rs. 100 per acre during the year.

(ii) *The Industrial Disputes (Amendment) Act 1953.*—Additional expenditure to the industry through implementation of the provisions in respect to lay-off of labour will be approximately Rs. 30 to Rs. 50 per acre per annum.

(iii) *Special Plantation Industrial Tribunal, Coimbatore.*—There is at present an Industrial Tribunal sitting to assess increased wage claims and while our members' liability, if any, is unknown, further discussions for increasing the minimum wage in Madras have already taken place. An interim award has since been made which will increase production costs by Rs. 50 per acre per annum.

As far as the necessity for rehabilitation of estates is concerned, the Association has pointed out in reply to Question No. 62 of your Questionnaire that the economic life-cycle of tea, coffee and rubber is limited to approximately 40 years in each case. The Association maintains that tea, coffee and rubber should be considered as wasting assets in as much as they deteriorate after the above-said economic life cycle is completed, and there comes a time when the yield is quite uneconomic. At this stage even uprooting of the old plants and replacing them with new ones will sometimes be useless, and it will be necessary to plant up virgin areas. This we suggest is

the equivalent of either opening a new coal mine, or accepting that plantations when they become uneconomic and have to be abandoned, are as fully entitled to be considered as wasting assets as the aforesaid mine. The tea bush is as exhausted as the coal mine and planters are as unable to rehabilitate a tea bush as coal miners are unable to extract coal from an exhausted mine. The Association considers that provision out of profits to pay for the cost of rehabilitation of estates has become an urgent necessity in view of the present age of a large area under plantation crops.

As regards item (2), the Association would point out that the ratio of 40:60 fixed by the Income-tax Department as representing the non-agricultural and agricultural portions of the income of tea estates has always been an arbitrary one, and at the present time, is not related to fact. The proportion of expenditure attributable to cultivation in a tea estate is at the present time considerably more than what it was ten or twenty years ago. In particular, the expenditure on manuring and pest control has, since World War II, gone up by a hundred per cent. or more. In our view, at least three quarters of the total expenditure of a tea estate should be considered agricultural and we therefore strongly urge that the existing ratio of 40:60 should be altered to 25:75. Under no circumstances should the rates of State Agricultural Income-tax exceed Central Income-tax.

The following example of tea manufacturing expenses as related to total expenditure for a group of 10,000 acres are deserving of note:—

Year	Tea Manufacture (Excluding Depreciation)	Total Cost
	cents.	cents.
1947/48	17-9	99-12
1948/49	21-63	114-83
1949/50	24-32	120-61
1950/51	21-33	103-57
1951/52	22-51	106-09
1952/53	22-90	110-88
Average	21-74	108-74

To illustrate this point further, whereas expenditure on pest control before 1947 was practically nil, expenditure on pest control due to Blister Blight cost at least an additional Rs. 40 to Rs. 60 per acre per annum. As regards manuring, there has been a substantial increase in the cost of Sulphate of Ammonia since pre-war, and although heavy applications of manure increased the crops it also becomes necessary to manure uneconomic acreages both for bringing their crops to an economic level and to avoid exhaustion of the soil.

We would draw your attention to the above quoted additional costs which the industry has to face in relation to the Consolidated Statement 'A' copy attached herewith, which was recently placed before the Plantation Industrial Tribunal in respect of 46 representative companies, and the Commission, we are sure, will appreciate the law of diminishing return as applied to taxation.

The Commission enquired about the details of the approximate finance required for working capital in tea estates. The working requirements of a tea estate could be estimated as being the equivalent of the revenue expenditure incurred by the estate on the previous year's working. As an accurate estimate of the finance required, we consider Rs. 1,000 per acre per annum as essential to maintain a tea estate in a reasonable condition and this does not allow for depreciation, overheads or profit, but is merely revenue expenditure incurred on the estate.

The Delegation would like to express to the Chairman and all the members of the Commission, their appreciation of the consideration shown, and should further information be required by the Commission, we shall do our best to provide the same."

STATEMENT 'A'

Consolidated Statement of Ordinary Capital, Working Capital, Profits and Appropriations in respect of 46 Companies for the Financing Years ending within the Years mentioned below.

Sl. No.	1948	1949	1950	1951	1952	1953
1. No. of Companies included in Summary	46	46	46	46	46	16
2. Ordinary Share Capital	12,37,07,126	12,48,07,126	12,54,13,467	12,74,13,036	13,00,29,188	7,81,39,601
3. Working Capital	4,79,79,291	5,09,47,495	5,76,57,677	6,71,92,602	6,50,40,737	3,97,37,936
4. Ordinary Share Capital plus Working Capital	17,16,86,417	17,57,54,621	18,30,71,144	19,46,05,638	19,50,70,225	11,78,77,537
5. Net Profits before Taxation and Appropriation	2,88,42,251	2,64,76,265	3,51,41,085	4,40,73,046	3,78,38,213	1,78,51,471
<i>Obligatory Appropriations:</i>						
6. Deduct Taxation or Taxation Reserve	1,14,25,497	1,26,08,420	1,56,28,330	1,67,01,808	1,46,10,400	63,50,048
7. Deduct preference Share Dividends	10,59,904	10,68,904	10,64,404	10,64,404	10,64,404	1,41,167
8. Deduct Reserve for Redemption of Debentures	6,01,333	6,86,333	4,13,573	5,84,033	1,97,133	58,333
9. Total Deductions	1,30,86,734	1,43,63,657	1,71,06,307	1,83,50,245	1,58,71,937	65,49,548

STATEMENT 'A'—contd.

Sl. No.	1948	1949	1950	1951	1952	1953
10. Net Profits after obligatory Appropriations .	1,57,55,517	1,21,12,608	1,80,34,778	2,57,22,801	2,19,66,276	1,13,01,923
11. <i>Deduct</i> Reserve for difference between Depreciation on Replacement values and Depreciation on Original Costs.	45,29,867	54,34,111	60,98,833	65,80,826	77,67,483	45,43,418
12. Net Profits after obligatory Appropriations and Reserve for Replacement of buildings, machinery, etc.	1,12,25,650	66,78,497	1,19,35,945	1,91,41,975	1,41,98,793	67,58,505
13. Percentage of (12) to (2)	9.1	5.4	9.5	15.0	10.9	8.6
14. Percentage of (12) to (4)	6.5	3.2	6.5	9.8	7.3	5.7
15. <i>Deduct</i> Reserve for Improvements .	31,24,047	37,47,663	42,06,692	45,38,501	53,56,885	31,33,392
16. Balance of Profits after Reserve for Improvements	81,01,603	29,30,834	77,29,253	1,46,03,474	88,41,908	36,25,113
17. Percentage of (16) to (2)	6.6	2.3	6.2	11.5	6.8	4.6
18. Percentage of (16) to (4)	4.7	1.7	4.2	7.5	4.5	3.1
19. Reserve for Rehabilitation (replacement) of planted area.	51,88,860	51,88,860	51,88,860	51,88,860	51,88,860	..
20. Net Profit per acre before reserving for Improvements and Rehabilitation.	Rs. 81.0	Rs. 48.2	Rs. 86.2	Rs. 138.2	Rs. 102.5	..
21. Percentage of 20 to average present market value per acre.	2.6	1.6	2.8	4.5	3.3	..



WEST BENGAL

CALCUTTA STOCK EXCHANGE

REPLY TO QUESTIONNAIRE OF TAXATION ENQUIRY COMMISSION.

PART I.—THE TAX SYSTEM.

Question 1.—Speaking of the objectives of a sound tax policy we have to observe that a tax policy must primarily aim at giving positive encouragement to capital formation. Achievement of such an objective would imply taking out of the pockets of the people as little by way of taxes as would permit them to accumulate savings for investment. But as taxes are also required to have fiscal adequacy, such a policy to be successful would first demand economic management of administration and elimination of all wasteful expenditure, so that the ultimate impact of taxation on the people would be as less onerous as possible. Whether the impact of taxation on the people is onerous or not is to be judged by the test of its relative effect upon the initiative, industry and thrift of the nation. For unless the community can continue to save and invest for the purpose of enlargement and renovation of the existing apparatus of production (with its far-reaching effect upon employment and general well-being), bearing at the same time the burden of taxation, there will be an inevitable end—economic stagnation and ultimate collapse of the Socio-economic system with consequences thereof for individual well-being not pleasant to contemplate.

In this connection, the place of the respective objectives as named by the Commission, in a sound tax policy may be stated as follows:—

(a) For reasons given below, the idea of having reduction in inequalities of income and wealth as an objective of a sound tax policy is preposterously absurd. In our opinion in the existing situation as prevailing in this country inequalities of income and wealth if sought to be reduced by increase or shift of the burden of taxation on the higher or the middle income groups, it will result in disaster and ruin for Indian economy—for under such a process the economic system will be deprived of its very source of capital funds. We emphatically hold the view that it cannot be effected by transfer of purchasing power from the higher to the lower income groups or by redistribution of inheritances. It has to be borne in mind that income and wealth do not just fall from heaven. *Income has to be earned, and wealth has to be produced.* In other words, they depend upon individual initiative, enterprise, effort, technical knowledge and thrift. In truth, the secret of reducing inequalities of income and wealth lies in *increasing the productivity of the people in the lower income groups.* Only by so doing can there be an increase in the *real income* of the people in the lower groups. For instance enough has been done in the past to mulct the people in the higher and middle income groups (who represent only 0.24 per cent. of the population) to make them contribute no less than 40 per cent. by way of direct taxation to the total revenue of the Central Exchequer for ensuring conferment of numerous kinds of social and other benefits on the people in the lower income groups, and the industries too have been forced under statutory obligations to benefit the labour in numerous ways, but what has been the result of all these attempts? Relevant statistics of big producing units in this country will show that exactly during the period the labour has been granted these amenities and monetary benefits, its *productivity* has steadily declined,—thereby breeding cost inflation in this country. Thus benefits to be of real value to the lower income groups must aim at increasing their real income by increasing their productivity. It cannot be ensured by mere grant of monetary benefits or by transfer of the purchasing power from one sector of the population to the other irrespective of their respective productive values. We would once again reiterate that if inequalities of income and wealth be sought to be reduced by taxation of the people in the upper and middle income groups, it will for the circumstances explained above, while failing to improve *really* the lot of the impoverished ones, on the contrary will impoverish the classes who had so long played the leading role in the industrial development of the country.

(b) As stated at the outset “encouragement of incentives to work, to save and to invest” should be the primary objective of a sound tax policy for a backward and under-developed country like India. This objective can be achieved only when the taxes are so contrived as to take out of the pockets of the investing section of the population as little as would permit them to save and continue the process of investment through which alone can our economic system progress. While taxes should be light enough to permit saving there should at the

same time be given positive incentives for investment by way of tax reliefs and concessions.

(c) Taxation can play a positive role in countering the forces of inflation or deflation only in special circumstances. For instance, in a period of war when capital goods become scarce, taxation is an efficient instrument for mopping up the extra purchasing power that cannot go into *real* investment. But in peace time investment is considered to be the most efficient instrument for mopping up the surplus purchasing power in the hands of the people, and if during such a time taxation comes to interfere with investment, the result will be greater inflation and economic frustration as at present. Referring to the present situation our then Finance Minister Dr. John Mathai said when he introduced the budget for 1950-51: “I have for some time held the view that the present level of taxation in this country is uneconomic in the sense that the economy of the country cannot bear it. I know there is a considerable body of academic opinion in the country which holds a different view, but I am perfectly clear in my mind that the effect of the present level of taxation is not disinflationary but positively inflationary because, if you take the line that the solution to the problem of inflation is production, then a very high level of taxation which reduces the margin of saving and the amount available for investment is a potential inflationary force”. In a situation like this, it is only stimulation of investment by tax reduction which can effectively thump down inflation. Speaking on this point in our previous Memorandum to the Commission we had observed: “A dynamic economic in which inflationary pressures are to be held to a minimum, requires a continuous flow of savings. Savings are the monetary counterpart of physical capital formation. Savings are encouraged if an incentive price is paid for thrift and if people have confidence in the stability of the monetary unit and in policies of the Government. Savings are discouraged if tax rates approach confiscatory levels and the Governments pay little heed to the ultimate economic effect of a high rate of taxation”. Now that the Government of India have committed themselves to a policy of disinflation since the 15th of November 1951, it should now be the aim of a sound tax policy to accentuate the process by lightening of the burden of taxation on the industries, so that costs may be reduced.

(d) Maintenance of the external balance of economy depends upon exports equating imports or exceeding the same. Any disequilibrium in balance of payments arising out of excess of imports both visible and invisible over exports visible and invisible requires to be set aright by employment of a part of the savings available for the financing of domestic capital investment for the purpose, thereby denuding the home industries of their needed resources. Stimulation of the volume of exports should, therefore, occupy a large place in a sound tax policy. The inordinately high export duties erstwhile imposed on jute goods and the surcharge on coal exports have ruined us in our overseas markets, thereby—greatly affecting our balance of payments position. In the framing of a suitable tax policy for export stimulation, competitive position of rival foreign sources of supply should always be taken into consideration.

In our opinion the Indian Tax system should be modified as follows:

- (i) In respect of objective marked (a) by reversal of the present infructuous policy in regard to reduction of the inequalities of income by taxation of people in the upper and middle income groups;
- (ii) In respect of objective marked (b) by reduction of present burden of taxation on the upper and middle income groups so that they may be properly induced to work, save and to invest;
- (iii) In respect of objective marked (c) by reduction of the present burden of taxation on industries, which has bred cost inflation; and
- (iv) in respect of objective marked (d) by reduction of the export duties on India's staple commodities and principal manufactured goods, so that there might be a large balance of payments in our favour to enable us to purchase capital goods from abroad for augmenting the national apparatus of production.

Question 2.—The Indian tax system lacks equity because of its lopsided character in imposing the major

burden of taxation on the shoulders of a narrow section of the population. In our preliminary Memorandum to the Commission we had pointed out that whereas 17 per cent. of the population contribute no less than 85 per cent. of the total revenue, on the other hand, 83 per cent. of the population contribute only 15 per cent. of the total revenue. *The chief criteria for determining the equity of a tax system should be "ability" and "benefit", that is to say, while some taxes should be levied according to "the ability to pay", others should be according to "the benefit received".* From this point of view equity in Indian Tax system can "possibly" be secured only by spreading the incidence of taxation over a wider sector of the population. This can be achieved to a great degree by reverting to the pre-war ratio between direct and indirect taxation. The relevant figures are cited below:

	1938-39 %	1951-52 %
Direct Taxes	23.3	40.0
Indirect Taxes	76.7	60.0
Total Taxes	100.0	100.0

(See also answer to Question No. 3.)

Question 3.—That the Indian Tax system does not adequately conform to the principle of ability to pay is proved:

First by the pre-war reversal of ratio between direct and indirect taxes. While payers of direct taxes who were mainly responsible for aiding capital formation and rearing up of innumerable charitable and socially beneficial institutions like schools, colleges, hospitals and dharamshalas have been mulcted more and more beyond their ability to pay, the payers of indirect taxes on the other hand, who have not been known to have ever contributed any thing directly to the augmentation of national wealth have more and more been exempted even from their pre-war ability to pay. The ever increasing burden of direct taxation on upper and middle income groups has led to the drying up of savings for investment with its consequential repercussions on capital formation and employment situation in the country. A readjustment of the mutual position of the direct and indirect tax-payers to their pre-war state is desirable at the moment to afford necessary incentives for investment. And it is being everywhere felt that all who would share in the benefits conferred by Governmental activities should contribute according to their means as far as indirect taxes are concerned.

Secondly, the non-conformity of the Indian tax system to the principle of ability to pay is also proved by the fact that the Indian agriculturist (as distinguished from agricultural labour) despite the tremendous rise in his income in recent years has been left more or less immune from any great burden of taxation *vis-a-vis* his brother in the industrial sector, who despite a fall in industrial income in recent years has been more and more subjected to a heavy and onerous burden of taxation. The relative position of income (and therefore of the ability to pay) of the industrialists and the agriculturist may be vividly brought out here by citation of the index number of wholesale prices of agricultural and industrial commodities in this country:

	August 1939	June 1953
Industrial Raw materials	100	481
Industrial Manufactures	100	370
Agricultural Commodities	100	496

It will thus be seen that of all sectors of the community it is the agriculturists who are now enjoying the benefit of highest rise in prices. *Vis-a-vis* that the prices of industrial manufactures rule too low,—with its impact upon cost of production and marginal revenue of the manufacturing concerns.

Question 4.—In our view the taxable capacity of the agricultural and working classes has not been adequately used by the Indian Tax system. It has, on the contrary, "exploited" to the maximum possible extent the taxable capacity of mainly three sections of the community: (1) the employed and salaried groups, (2) the self-employed persons and professional classes, and (3) the industrialists and businessmen. In the past these classes were the main builders of capital in the country. Whereas the working classes, who have never played any directly active role in the investment history of the country and whose ability to pay has certainly gone up in recent years due to their being the recipients of numerous benefits, have been more and more relieved of tax burdens as the regressive trend in indirect taxation would show. The same is also the case with agriculturists (as distinguished from agricultural labourers) who contribute only one per cent. to the State Exchequer by way of agricultural income-tax (as against 40 per cent. by non-agriculturists) although as compared with others their income has seen the largest rise since 1939. In truth, the taxable capacity

of the agriculturists has not been fully used by the Indian Tax system.

Question 5.—It will be inappropriate to compare the proportion of tax revenue to national income of an underdeveloped country like India with that of highly developed countries of the West like the U.K. or U.S.A. In truth this percentage is not small when we compare it with that of an underdeveloped country like Poland, where the relevant percentage is 13.3. Again in India the per capita income of the people is insignificantly low as compared with the per capita income of the people in the countries of the West. Then for the institution of such a comparison it will be grievously wrong to look at it from the point of view of the overall impact of the tax burden on the community as a whole. In our opinion for such a comparison it is the burden of taxation on the individual which is to be taken as a basis and not of its impact on the community or the nation as a whole. From this point of view the burden of taxation in India is not the least below the standards of the West,—though India is a far less developed country. This will be evident from the following figures relating to the percentage of income taken away as income-tax at the higher levels of income in some of the countries of the world (as previously also given in our preliminary Memorandum on the subject):

Income Rs.	India %	U. K. %	U. S. A. %	Japan %
1,00,000	50.1	58.2	31.6	55.0
2,00,000	65.2	74.1	47.1	55.0
3,00,000	71.1	81.9	56.2	55.0
5,00,000	75.3	88.1	66.9	55.0
10,00,000	78.5	92.8*	78.2	55.0

* In U.K. this percentage is considerably reduced by grant of numerous reliefs and concessions, and by refund to the shareholders of the whole of the tax paid by a company on dividends, whereas in India the super-tax is not so refundable.

We think that at the present level of national income the proportion of income paid by way of income-tax is too high for India, and needs to be substantially reduced, rather than raised.

Question 6.—In dealing with Question No. 2 we have already stated it that the relative place of direct and indirect taxes in the Indian tax system is not satisfactory. The whole position needs to be changed by reversal of the respective trends of direct and indirect taxes to their pre-war level. It is worthwhile noting in this connection that in the countries of the West the recent trend in tax policy is towards reducing the burden of direct taxes and increasing that of indirect ones. Thus in the U. K. direct taxes formed 63 per cent. of the total tax revenue in 1924-25, 59 per cent. in 1928-29, 56 per cent. in 1938-39 and 54 per cent. in 1948-49. On the other hand indirect taxes which formed 23 per cent. in 1924-25, were increased to constitute 41 per cent. of the total tax revenue in 1928-29, 44 per cent. in 1938-39 and 46 per cent. in 1948-49. Indeed it is being felt everywhere that all who would derive benefit from the services rendered by the Government, should contribute according to their means, which as far as indirect taxes are concerned, would be reflected in their total consumption of taxed goods. Further in view of the fact that high direct taxation has in recent years retarded the growth of savings for capital formation, thereby checking economic progress, it should be substantially reduced, so that savings may once again accumulate for investment.

Question 7.—The present trend of Government of India's income from non-tax revenues does not enthruse us to believe that these "are likely in future to occupy a more important place than hitherto in the public revenues of India". The following table brings out this trend clearly:—

Year	Total Revenue (In Crores of Rupees)	Non-Tax Revenue	% of Non-Tax Revenue
1938-39	84.47	10.57	12.4
1948-49	371.70	51.76	13.9
1949-50	350.39	38.85	11.1
1950-51	410.66	53.66	10.3
1951-52	515.36	55.37	10.7
1952-53	418.64	46.35	11.0
1953-54	437.76	40.32	9.4

It will be seen from the figures given in the table above that the Government of India's income from non-tax revenues in recent years has a tendency more towards regression than towards progression. This has been due to the restrictive effect of higher rates on the traffic of

the Railways, Posts and Telegraphs. This will be obvious particularly from the net contribution to General Revenue of Posts and Telegraphs Dept.

(In Crores of Rupees.)	
1950-51	3.98
1951-52	3.43
1952-53	1.40
1953-54	0.40

Nevertheless we do not entirely deny the scope of revenue from non-tax sources like the railways increasing, if the corrupt practices and wasteful expenditures of the department are checked. Reduction of railway freights and postal rates and reintroduction of concessional tickets for wider travelling may also help Government in raising larger revenue from these sources.

If, however, the Commission has in mind in this context the revenues from Development Projects and other nationalised industries, we have to observe that judged by their failures in the past and bearing in mind their top-heavy expenditure, the lack of required technical and business experience on the part of those responsible for their management, and losses sustained by some of the State-owned enterprises like the State Transports, we cannot hold very high hopes about their capacity to contribute anything worthwhile non-tax revenue directly to the public exchequer. Indirectly, however, the Plan when executed may help the railways carry additional goods to be brought into being and thus aid in increasing the revenue from non-tax sources. Again, if enough incentives are given by way of tax reliefs and concessions, etc., to private investors to implement that part of the Plan which has been entrusted to the private sector for execution, then the increased traffic accruing therefrom would also help Government in having increased revenue from non-tax sources like railways, posts and telegraphs, etc.

Question 8.—While agreeing with the general principle of it that receipts from particular taxes should not, as a rule, be funded or earmarked for specific purposes, yet we consider it advisable that excises and cesses or similar other imposts levied for special purposes should be earmarked and utilised for specific purposes. In this connection we need point out that there is a general complaint from the private sector in this country that the cesses realised from the sugar industry have not been fully utilised for the conduct of research on sugar and sugarcane. Apart from the utilisation of the cesses for purpose like this, we are also of the opinion that a part of the proceeds from excise duties should also be earmarked for expenditure on research and development schemes aimed at improving the quality and marketability particularly of those commodities which on account of their high prices meet with consumer resistance both at home and abroad. Any such pruning of costs will stimulate consumption and thereby bring in larger revenue to the Government from excise duties. We do also claim that occasional windfall from emergency surcharges like those erstwhile imposed on the export of jute goods and coal should likewise be separately earmarked for subsidising exports. But when granting such subsidies on export of raw materials, it should be seen that such subsidies may not help India's competitors abroad to reduce their cost of production to the detriment of our own industries. Otherwise, all receipts from taxes should go to the Consolidated Fund.

Question 9.—Yes, only under certain circumstances it may be considered desirable to levy cesses for special purposes, provided, of course, that the industries concerned can bear it. The levies we have in view in this context are the cesses for the conduct of research and investigations within the industry with a view to improving the quality or standard of goods manufactured thus reducing the cost of production. In this connection it should be added that a cess like that imposed on the cotton textile industry since December last is repugnant on the ground that while it penalises and impoverishes the industry taxed, it helps and enriches, on the other hand, its rival.

Question 10.—See our answers to Question No. 7. For the reasons given, we do not desire their extensions any further. They have so far been failures as stated therein.

Question 11.—We think that from the point of view of equity any surplus earned by State undertakings should accrue to general revenues (as is the case with railways, posts and telegraphs etc. at present), so that the benefit may be applied towards affording proper relief to the group of tax-payers in the upper and middle income groups who are now being exploited most to bear the burden of the development expenditures.

Incidence of Taxation:

Question 12.—In examining the incidence of taxation on various classes of people, we think, the basis of differentiation should be (a) income and (b) occupation. The propensity of the class to save and invest should also be a basis in this connection. Where the economic contribution of the section to the productive system of the

country is considered to be of value to the community, a lower proportion of tax requires to be levied.

Question 13.—We do not think that the burden of the present tax system is fairly distributed among (a) various classes of people, and also (b) among different States. At present the urban population who form less than one-fifth of the total population bear more than four-fifths of the total burden of taxation, while the rural population who number more than four-fifths bear less than one-fifth of the total tax burden. In regard to income-tax too the present tax-burden is not fairly distributed between agricultural and industrial classes. Then again in the case of the proportionate distribution of the proceeds from income-tax amongst the States, West Bengal's share, we consider, is inequitously low.

Question 14.—No. As the table cited in answer to Question No. 3 will show the shifts in the distribution of income in the community in recent years have mainly gone in favour of the agricultural and working classes. Yet as the diminishing incidence of indirect taxation (*vide* answers to Question No. 2) in recent years would show these classes have steadily been spared even the pre-existing burden of taxation, not to speak of being made to bear any additional incidence of taxation in proportion to the recent shifts in their income. It has already been dwelt on in answer to Question No. 4 that whereas the income of the agricultural class has seen the largest rise in recent years, yet they contribute only 1 per cent. to State revenues, and although the industries are in a bad plight, and their profits are on the downward trend yet they are made to contribute no less than 40 per cent. by way of income-tax to the public exchequer. In truth, the relative incidence of taxation in recent years has been in inverse ratio to their recent shifts in income that have taken place.

Question 15.—Yes, we think that the cost of compliance with tax regulations adds materially to the burden of taxation. It is particularly so with regard to income-taxes. The complicated methods of computation of assessable profits involve much extra work and expense for the assessee. The complexity arises from statutory provisions relating to such items as restricted profits, excess dividends, depreciation allowances and so forth. In truth enormous time and money are spent by assessees in calculating depreciation based on the month when the building is completed or the machinery is installed. While these calculations involve great expense for both the assessees and the taxing authority, they do not benefit the exchequer proportionately. The exchequer would not indeed suffer any great loss of revenue, if the previous method of calculating depreciation on the additions for any particular year for the whole of the year be restored. Then again arbitrary assessments and harassing tactics of the Tax Departments arising out of the complexities of the law and the wide latitude given to the officers concerned in regard to the interpretation and application of statutory provisions, needing on the part of the assessee the aid of consulting specialists and experts, frequently involve considerable loss of time and money. It is particularly so, when the I.T.O.'s reopening assessment under Section 34(a) of the Act. Then again the multipoint sales tax system as adopted by certain States and the claims of certain States that they can claim sales Tax from non-resident dealers who send goods into those States for consumption there has now involved on the part of the dealers not only to keep elaborate sets of accounts according to the destinations of the goods sold, but also to maintain establishments in each and every State to look after their assessment affairs. That the cost of all this materially adds to the burden of taxation is palpable enough.

Question 16.—The activities of a government and the utility of its services must be judged by results. Unfortunately there are no concrete tests and standards for measuring the economic results of public expenditures. So far, however, as the structure of taxation in this country is concerned, it is found that benefits from public expenditure do not accrue to the class which bear the main brunt of the burden of taxation. Thus between 1938-39 and 1951-52 while public expenditure has gone up by 376 per cent., the burden of taxation on the middle income groups as represented by *direct taxes* has gone up by 929 per cent. Yet during this period the middle classes have derived no benefit from public expenditure. The middle classes on the other hand, have during this period been unceasingly penalised with various kinds of confiscatory levies, with the sad repercussions thereof on the country's economic progress, as is unmistakably proved by the stagnant condition of the investment market.

Question 17.—Yes, the tax burden is particularly heavy on such industries as the Jute Mills and Cotton textiles, which at the moment badly stand in need of rationalisation. The income-taxes have in recent years taken away the biggest slices out of their profits, a part of which if they were allowed to retain could have profitably been utilised in modernising their plants. In the

Jute Mill Industry, for instance, between 1940 and 1952, only 8 mills paid no less than Rs. 12,00,28,793 by way of income-taxes. In the past the jute mill industry expanded mainly by reinvestment of past profits as kept in Reserves. But these Reserves are now being fast depleted due to depression in the industry. Thus since the partition of the country no less than Rs. 4,29,13,177 has been withdrawn from the Reserves by the Jute Mills to write down working losses. Apart from income-taxes, other imposts on the Indian Industries also work heavily. In the Cotton Mill Industry, for instance, such imposts work out to 20 per cent. of the total cost of production. So is also the case perhaps with sugar. This has bred cost inflation with increasing consumer resistance to current prices. In some cases the imposts have also ruined our overseas markets. The recent enhancement of export duties on jute goods and the surcharge on coal exports have put the Indian industries in a bad plight so far as their overseas markets are concerned.

Taxation and Economic Development.

Question 18.—On principle we do think that resort should be taken to borrowing and not to taxation to finance the Development projects. We think the burden of taxation has gone up so much in recent years to meet the cost of ever-expanding administrative expenditure that there is now no further scope for the raising of any further revenue by taxation to meet the cost of development programme of the country. We are compelled to observe in this connection that the Planning Commission made the mistake of not fully taking into account the limitation of the existing and potential tax sources of the country. Instead of tailoring the garment according to the fabric, they took too much for granted as far as the capacity of the people to shoulder the financial burden of the Plan. For instance, they assumed not only that the existing revenue from taxation would be maintained and that an additional tax revenue would be forthcoming, but that the private sector would also draw its sustenance from the same pool of resources which supplies the tax revenue for the financing of that part of the plan which has been assigned to it for implementation. Subsequent events have proved that they were entirely wrong in their assumption. We are of the opinion that the programme for a particular period should be sized down to the limit of the financial resources available during the period. As stated at the outset, for the financing of the Plan, greater reliance has to be laid on borrowing. But as the internal resources of the domestic market are now limited as to their volume, fullest exploitation of the domestic capital market for the purpose of financing the Plan will simply lead to a state of denudation and exhaustion in which it will be difficult for the private sector to draw its sustenance either for the extension of existing apparatus of production or for the creation of new industries to create fresh scope for employment in the country, or for the matter of that to play the role that has been assigned to it in the Five Year Plan. In their report dated the 4th July 1953 the Planning Commission stated that they are disturbed to discover "the inability of the private sector to maintain the rate of investment according to their plan and programme". They further stated: "It appears that the growth of fresh employment opportunities, especially in the private sector, has not kept pace with the numbers seeking work". In view of all this it is considered advisable (i) to leave the domestic capital market principally to private enterprise for drawing its sustenance therefrom, and (ii) to finance the plan mainly with the help of money borrowed from the World Bank which has been set up with the avowed object of providing finance for the development projects of the under-developed countries.

Question 19.—For maximisation of the resources required for the financing of development, the primary importance in our view should be given to—(a) economy and rationalisation in public expenditure in this country. (b) Some degree of importance can also be attached to resources obtained by prevention of tax avoidance and tax evasion, but for this the taxes have to be made less onerous and devoid of the whimsical pranks of the Tax Departments. (c) There is no scope for increasing the burden of existing direct taxes on the middle classes of population. (d) Fresh taxes may be raised by reimposition of the duty on salt, and also on liquors in those States where a policy of prohibition has recently been launched. (e) As observed in answer to Question No. 6 non-tax revenues can be developed only by elimination of corruption and by reduction of the rail freights and postal rates.

Question 20.—For if both the public and the private sectors have to draw resources for the purpose from the domestic capital market, then the tax policy of the country should be so framed as to encourage saving and investment in the country. This would imply the giving of proper tax reliefs and concessions to corporate institutions as also to those classes of people who have so far been responsible for the growth of investments in this country and among whom rank the salaried and profes-

sional classes, the businessmen and industrialists, and self-employed persons. Only a tax policy so devised will ensure a steady flow of resources for the implementation of the development programme of the country in both the sectors.

Question 21.—As stated in our answer to Question 18, taxation should not be assigned a direct role in finding the additional resources required for the development programme of the country. The formulation of a realistic tax policy can, however, stimulate the growth and accumulation of resources required for the purposes named. A tax policy realistically formulated can play a large role in stimulating capital formation in both private and public sectors, if it affords positive incentives for saving and investment. A realistic tax-policy on this score should help to create a situation in which (a) the willingness of an individual to put forward his maximum effort towards thrift and risk-taking will be accelerated, (b) the industries will be enabled to set aside out of profits reasonable sums to ensure working capital and to replace capital equipment, and (c) private individuals will be stimulated to provide Government and industry with fresh capital as and when required. Some of the lines on which appropriate reliefs can be given to stimulate capital formation in this country are as follows:—

- (a) The super-tax on Company profits should be put back to its previous level of 1 anna in the rupee, and that small companies with incomes below Rs. 25,000 should be exempted from super-tax.
- (b) The relief under Section 56A of the Income Tax Act should be extended to all companies and to "individual" members of companies as well.
- (c) In our view Sec. 23A is unsuited to the conditions of Indian economy today. The other countries which adopted that legislation did so at a time when they were industrially advanced and on account of there being no supertax on companies, some companies adopted the expedient of keeping the profits undistributed. In consequence, neither the company nor the shareholders paid any super-tax. Here in India, on the other hand, companies are supertaxed. There is, besides, the genuine hardship in respect of such companies as have utilised their entire profits of the year in expansion of plant or replacement thereof or otherwise. Application of Sec. 23A to such Companies cannot but act as a curb to expansion and production. Even in England, in its advanced state of industrial economy, particular considerations touching companies individually are taken into account by the Revenue Authorities. The Indian legislation, on the other hand, is rigid.
- (d) The maximum rate of taxation on personal incomes should not exceed 66½ per cent. in all and the average rate of taxation should be applied to incomes of over Rs. 5 lakhs. In the case of incomes below Rs. 1 lakh, the maximum rate should not exceed 25 per cent. in all.
- (e) In respect of assessment of personal incomes proper reliefs on the same lines as are in vogue in the countries of the West should be given. Such reliefs should include (i) house-keepers' allowance, (ii) children's allowance, (iii) dependents' allowances, etc. Further a married man's income is split into two in the U.S.A., one half being regarded as the wife's income. Such splitting up of incomes of married men as also of joint families needs to be also introduced in this country.

Question 22.—In view of the fact that we have now committed ourselves to a policy of development and that a distinct role has been assigned in it to private enterprise, it would be wrong on our part to compare the present situation with that in the pre-war period. All evidence point to it that the rate of private capital formation has considerably come down since 1948. Due to the difficulty of obtaining capital equipments from abroad during the period of the war, there was no growth of real capital during the period. In the years immediately following the termination of the war there was, of course, some degree of capital formation in this country due to the coming into being of some new industries. But this process virtually came to an end after 1948. This has been due to two factors: (1) dearth of venture capital, and (2) high taxation on the incentive to invest. The first factor is due to the impact of inflation and high rates of taxation on the middle classes which alone used to make substantial contribution to the total capital funds of the country in the pre-war period. The second is due to the impact of high taxation on corporate profits. It is postulated that if a large slice of profits be taken away by way of taxation, thus depriving the companies of their store of resources for weathering the inclemencies of adverse times, then the rate of business mortality will

be very high when there comes about an adverse turn in the business cycle, thereby putting to grief the group who would sink venture capital in them. It is this prospective failure of business concerns arising out of their being deprived of the resources to weather adverse times in future, which is deterring investors from risking fresh capital in industries. The constant shifts in economic policy, burdensome labour legislations and quixotic measures like Capital Gains Tax, Dividend Limitation, etc. have also been potent factors in this direction.

The lower rate of capital formation in recent years has also been noticed by the Planning Commission who in their report dated the 4th July 1953 made the observation that they were disturbed to discover "the inability of the private sector to maintain the rate of investment according to their plan and programme". Then apart from this process of slowing down of new capital formation in recent years, there has not also been adequate replenishment of old capital due to the inadequacy of depreciation allowances under the Indian Tax System. Whereas the cost of capital goods has gone up by 200 to 300 per cent., provision for the wearing and tearing of existing capital is being allowed on the basis of the cost value of assets and not on their present value.

We believe that in investigating the phenomena covered by their Question No. 22(i) it will not be correct on the part of the Taxation Enquiry Commission to assess the current situation in the perspective of pre-war standards. The large increase in population, the question of providing employment for them, and the aim of the Planning Commission to raise the general standard of living of the people, all imply a rate of capital formation much in excess of what it was in the pre-war period.

(ii) Yes, there has been a shift in recent years in the sources of capital formation in the private sector as between individuals, corporations and other institutions. In recent years the contribution of individuals to capital formation in the private sector has greatly come down due to the operation of the factors noted in this context above. As a result Corporations are unable to raise new venture capital. For a time they met their capital requirements by means of mortgage loans. And still later by capitalisation of reserves. But the reserves are also fast being depleted on account of these being applied towards the wiping out of losses. Thus in the Jute Mill Industry no less than Rs. 4.29 crores have been withdrawn from the reserves to write down losses during the past few years. Among institutional investors it is only the insurance companies who are now found to be enlarging their holdings of corporate securities, but in this case too the equity capital figures insignificant.

Question 23.—We believe that tax-relief in respect of persons in the upper and middle income groups would assist the growth of savings. The present incapacity of persons in the middle-income group to save anything out of their income is mainly due to their efforts to maintain their pre-existing standard of consumption more or less in tact under the current impact of inflation and high taxation. As such any relief that is afforded to this class would assist the growth of savings rather than stimulate any propensity to consume.

Question 24.—The Planning Commission have made it clear that the main objective of the planned effort at increasing the national wealth of the country is to raise the standard of living of the people. This obviously implies larger consumption. By far the largest investment under the Five Year Plan has been visualised in the field of basic industries, and power production, Agriculture and Food production. The bulk of the output will be capital goods, and as such they will naturally flow into investment. So far, however, as consumer goods are concerned, in the field of agriculture the main objective of the planners is first to raise the output of raw materials so that the existing gaps may be bridged, and secondly to increase food production so that the people may have adequate food from the nutritional point of view. As for food production the targets as fixed by the planners fall far too short of the food that will be required by the existing population as also by the population that will come into being during the period of the execution of the plan. As regards raw materials, any surplus quantity remaining after meeting the needs of the domestic industries may be exported abroad, and the proceeds therefrom may be utilised for the import of capital goods from abroad, thereby helping in the process of capital formation in the country. Without commenting on the percentage of additional output that may go into investment under the circumstances described above, a measure that we think may be necessary in the field of taxation to effect capital formation with the help of export surplus is to reduce the present level of export duties so that our surplus exports may find a ready market abroad.

Question 25.—It follows from answer to Q. 24 that the main objective of the Plan being to raise the standard of living of the people, consumption standards are to rise when the Five Year Plan is implemented. It is well-known that consumption standards are already too low

in India and any attempt at controlling them further, would merely accentuate the poverty of the nation. If, however, the right type of emphasis is laid on the consumption of those goods which are subjected to indirect taxation, then the additional revenue obtained from indirect taxation on the specific commodities consumed by them will make available to the nation extra resources that might be utilised for reinvestment in national wealth and also for grant of relief to the payers of direct taxes. We have already made it clear in course of our preceding answers to this Questionnaire that any additional proceeds from indirect taxation should be applied towards effecting a simultaneous reduction in the burden of direct taxation, so that the ratio between the two may be put back to its pre-war level. For, it has to be borne in mind that so far the exorbitant increase in direct taxation instead of helping in capital formation has worked in the opposite direction of annihilating the very sources of capital funds. There should, therefore, be increased reliance laid on indirect taxation than on direct taxation like income-tax etc. In this respect we may profitably adopt the methods of the west namely that of making the direct taxation regressive and the indirect taxation progressive.

Question 26.—The efficiency of the productive system depends on (a) legitimate profit expectations which build up the proper morale and psychological attitude of the businessmen to put forward his maximum effort, (2) rationalisation of productive machinery so as to be able to produce goods at competitive costs, and (3) willingness of investors to provide industry with fresh capital as and when required. Now so far as these conditions are concerned the Indian Tax System has destroyed desideratum No. (1) by high rates of taxation, has made No. (2) difficult by grant of scanty allowances for depreciation, and has choked up No. (3) by making saving impossible for the middle classes and denying them any positive incentives for investment. A tax policy which will ensure all these three desiderata would substantially promote the efficiency of the productive system.

The multiplicity of taxes and their lack of uniformity from State to State do positively hinder the efficiency of the economy. The different rate of excise duties on Coal and Sugar in different States, the diverse rates of agricultural income-tax on tea industry in West Bengal and Bihar, and the surcharges on stamp duty on transfer of shares in U. P., Bombay and Madras in addition to the basic Union Stamp Duty, all impair the smooth working of the economic system, and divert the flow of business from one State to the other. All these impediments can be removed by rationalisation of the tax system. The tax system can be greatly rationalised (so far, of course, as efficiency of production is concerned) by removal of hindrances named under (1), (2) and (3) above, and by greater integration and uniformity of the excise duties, the Sales Tax, the Agricultural Income-tax, and the cesses on different industries like coal mining, etc., and also by abolition of the surcharges on the stamp duty on transfer of shares in some of the States.

Question 27.—So far as the private sector is concerned the entire task of industrial development under the Five Year Plan has been entrusted to it. In our opinion priority should be given in the tax system to enable the private sector execute it successfully. This can be secured by giving of proper incentives for profit-taking. In this connection, the Planning Commission observed: "Private enterprise operating in terms of legitimate profit expectations and efficient use of available resources has an important part to play in developing the economy". But under the present impact of cost inflation and high taxation the requisite climate for legitimate profit expectations has been completely destroyed. In this connection it should be noted that legitimate profit does not merely imply a return to shareholders in terms of the market yields on securities, but it as well indicate a source of funds for financing further development or of storing resources to counteract the adversities of the future. To build up an appropriate climate for legitimate profit expectations, the tax system should be so devised as to afford general relief to the industries in their present overall burden of taxation. As for priorities special reliefs can be provided for in the tax system for those industries which will make efficient use of available resources or a system of protection may be adopted in respect of those industries which produce such of the consumer goods, imports of which at present drain away considerable amount of national resources.

Question 28.—The possibilities and limitations of tax policy as an instrument for economic development by means of the expedients named are as follows:—(a) Economic development can be achieved by acceleration of the over-all demand for those commodities which bear indirect taxation and by reinvestment of part of the additional proceeds therefrom on further augmentation of wealth and in grant of relief to the bearers of direct taxation. (b) In the present circumstances there is no scope for reduction of consumption. The consumption

standards are already too low, and it is the object of the Five Year Plan to rectify this deficiency. Unessential investments can be checked by refusal of licenses for them and by giving of positive inducements for desirable investments. (c) Positive inducements for desirable investment can be given by grant of tax reliefs and if necessary tariff protection to such industries. (d) So long as the working and the agricultural classes do not imbibe the habit of investing their surplus income in industrial investments, any process of redistribution of incomes by means of taxation will simply result in drying up the very channel through which capital formation in this country has taken place in the past.

Question 29.—We believe both tax policy and monetary policy, if judiciously framed and pursued, have their scope and efficacy as an instrument of planned economic development. So far as monetary policy is concerned, regulation of interest rates and of other conditions affecting lending and the volume of credit, especially bank credit, has been the traditional over-all policy for influencing the aggregate flow of national expenditure and income. A reduction of interest rates and liberalisation of other terms of lending was thought to promote a general expansion, while a rise in rates and tightening of other conditions would tend to check expansion or bring about contraction. In the past, emphasis was laid on the stabilisation of the price level, but it is now generally agreed that what matters is rather the volume of expenditure and income, of which prices are only one symptom and not an unfailing one at that. Credit policy, if effective, operates on aggregate expenditure mainly by directly influencing private investment, including expenditure on durable consumer goods.

But the policy recently pursued in this country has ignored all this. The price level has been sought to be stabilised by restriction of credit without any attention to the volume of expenditure and income, of which the prices are a symptom. This has resulted in making borrowing hard for the industries, thus accentuating the already existing cost-inflation in this country with its immediate repercussions upon the profitability of the concerns and far-reaching effect upon private investment. On the contrary if stabilisation of the price level had been sought to be achieved by formulation of a suitable fiscal policy in which the levy of direct taxes was so lightened as to increase the incentive to undertake new investments, to inaugurate improvements, or to maintain working stocks of raw materials or goods in process or manufactured goods, and in which the proportion of indirect taxes were so raised as to absorb the surplus purchasing power in the hands of the non-investing public, then the economic system might have more smoothly worked for desired development of the country. In the formulation of correct monetary and fiscal policies, it has to be clearly borne in mind that the current inflation in India is nation-wide in its scope and as such a clue to its solution lies in absorbing the surplus purchasing power in the hands of non-investing public.

Question 30.—See answer to Question No. 1(a).

Question 31.—We have already stated it in answer to Question No. 16 that between 1938-39 and 1951-52 while public expenditure has increased by 376 per cent., the burden of direct taxation on the upper and middle income groups, on the other hand has gone up by as much as 929 per cent. The ratio of indirect taxation to total revenue has at the same time come down from 76·7 per cent. to 60 per cent. This shows the inequality of the burden imposed on the upper and middle income groups who, be it said, have received no corresponding benefits from services rendered to the lower income groups who are mainly the payers of indirect taxes. As the tremendous impact of direct taxation on the higher and middle income groups has denuded the economic system of its supply of investment funds, thereby impeding larger production, a larger degree of economic equality, consistently with maintaining the incentives to capital formation and higher production, can, in the circumstance, be secured only by reversal of the ratio between the direct and indirect taxation to their pre-war position. If the high rates of direct taxation are reduced and proper reliefs given, the middle classes will be enabled to save investible funds and would also get stimulus for capital formation. This will result in higher production, greater employment and cheaper prices. The working class will thus be better off due to full employment, larger income and reduction in prices. Thus a modification of tax system on the lines suggested would secure a larger degree of economic equality consistently with maintaining the incentives for capital formation and higher production.

Question 32.—In as much as inflation arising out of unbalanced budgets nullifies the beneficial effect of such measures as are intended to bring about equality of incomes (e.g., as wage increases, etc.) greater degree of equality of income can be achieved if Governments endeavour to make balanced expenditure. The second way in which public expenditure can achieve a greater

measure of equality of income is by (a) increasing the efficiency of administrative services thereby bringing about a reduction in non-productive expenditures; and (b) laying of greater stress on productive expenditure such as that on increasing the productivity of people in the lower income groups. Emphasis, for instance, may be laid on the training of citizens to acquire greater skills. Acquisition of such skills will contribute productivity of higher value to the production of national wealth. For it is evident that the income of the individual depends upon the amount of resources (in the form of skill, labour, capital, etc.) he puts into the production of national wealth. And greater is the value of these resources, greater will be the income of the individual. We believe public expenditure so directed as suggested above, will achieve a greater measure of equality of income than any measure of taxation.

Question 33.—Private foreign investors are at the moment frightened by the heavy structure of Indian taxation. Yet they are investing in other countries where tax burdens are lighter and where thus exists the appropriate climate for investment. For the creation of appropriate climate for foreign investment by changes in tax policy we suggest: (a) reduction of the overall burden of taxation of business, etc., at par with that prevalent in other underdeveloped countries, and (b) grant of such reliefs to business, etc., as are prevalent elsewhere. We do not, of course, mean that such changes in tax policy on the lines suggested are to be effected for the benefit of foreign investors alone. What we mean is that the entire climate for investment of domestic capital market is to be so metamorphosed by tax changes as would attract both domestic and foreign investors.

Question 34.—Without commenting on the other items we should like to say that so far as (b) is concerned, estate duties have been levied in the countries of West at a period of substantial advancement in their national economy. No country of the world is known to have imposed it at a stage of economic development in which Indian economy is at the moment. So far as (d) is concerned any taxes on railway fares and freights would merely breed further cost inflation to aggravate the distress of the lower classes. So far as (e) is concerned it will be a further retrograde process to jeopardise the investment habit of the nation by imposition of taxes other than stamp duties on stock market transactions. What is needed today is to offer incentives to them and not to give them further jitters. For investors invest in stocks and shares with a view to liquidating them on the Stock Exchanges as and when needed. Any additional taxation (other than stamp duties) will have to be ultimately borne by them, and as such it will deter them further from investing their savings in stocks and shares. In the present moribund condition of the Stock Market, any tax on mere transactions, irrespective of whether one has made a loss or profit out of it will simply take away the last breath out of it. Any reactionary tax like this cannot add to the country's tax resources. Rather if by offer of proper incentives, investment habits of the people are stimulated that would add to the tax resources of the country by enlarged income from stamp duties.

Question 35.—Our views on "the other possible ways of adding to tax receipts" are as follows:

- (a) Taxes on capital are not desirable inasmuch as these will have their adverse effect upon the growth of savings and investment. The Government of India had erstwhile some bitter experience with the Capital Gains Tax.
- (b) Reintroduction of Salt Duty is highly desirable inasmuch as as an indirect taxation it has the merit of imposing least burden on the citizens and at the same time contributing substantial revenue to the national exchequer.
- (c) Surcharges on land revenue may be considered expedient where rents are not subject to periodic revisions. It should be noted in this connection that while the share of land revenue in total revenue was 25 per cent. in 1939 and it came down to 8 per cent. in 1950-51.
- (d) We strongly object to a levy on unearned increments in value of land and other property. When the Government will naturally have increased revenue from the products of the improved lands, an additional levy on unearned increments in value of land is considered by us to be repugnant.
- (e) Agricultural income tax is already imposed in several States. It may be imposed in other States too where there is no such taxation at the moment. It should be noted that agricultural income-tax contributes at present only 1 per cent. to the revenues of the States, as against 40 per cent. to the Central Exchequer by non-agricultural income-tax.
- (f) Social security taxes are not considered desirable

- (g) Policy of prohibition introduced in certain States needs to be immediately reversed. They have deprived these States of a substantial amount of revenue without at the same time conferring any corresponding social benefit. For it has merely led to bootleggers being rampant in the States.

Question 36.—No. Under Q. 35 we have suggested that no betterment fees should be levied. See answer to Question No. 35 under sub-para (d).

Question 37.—So far as existing sources of revenue are concerned, we believe the imposts on business have already reached their saturation point and any further attempt at increasing receipts from them would bring diminishing returns. It is noteworthy in this connection that whereas Agriculture looms large in national activity, yet it is subjected to a far lesser degree of taxation than business. Land revenue, for instance, contributes only 9 per cent., and Agricultural Income-Tax 1 per cent., whereas Income-tax on business and professions 40 per cent. to the respective State and Central exchequers. Additional revenues from land revenue and agricultural income tax may be tapped. Income from non-tax revenues may also be enlarged as suggested in our answer to Question No. 7.

Question 38.—Some of these have been suggested in answer to Question No. 35.

Question 39.—We think these powers should not be used at the present juncture.

Taxation and Inflationary and Deflationary Situations.

Question 40.—Pure inflationary or deflationary situations can be controlled either by regulation of investment or by both. For controlling the inflationary situation during the war period, taxation was considered to be an efficient instrument, as there was then limited scope for investment due to unavailability of capital goods during the period. Now however capital goods are available and the country needs investment on a large scale. Inflationary situation should, therefore, be controlled by stimulation of private investment. Use of taxation as an expedient to control inflation without stimulating investment as at the moment would simply aggravate inflation just as it has done at the moment. And there is its limitation.

Question 41.—In as much as only an infinitesimal percentage of the population bear the burden of direct taxation, any changes in same cannot be used as a countering force to check a nation wide inflation in the country. If the adoption of a fiscal instrument is necessary at all, the proper method for dealing with an inflationary situation is by indirect taxation, notably by changes in import duties and excise duties. Upward changes in export duties will merely jeopardise Indian economy just as it has done in the case of the jute goods and other commodities in recent years, thereby leaving their impress upon the balance of payments position.

Question 42.—As stated in answer to Question No. 41 the tax-system can be used as an instrument for counteracting inflationary conditions, if and when the taxation measures are widely distributed to bring under its coverage all sections of people, particularly the primary producers and the wage-earners

Question 43.—Non-productive public expenditure, if judiciously curtailed, will greatly help in moderating the forces of inflation. Again, public expenditures in connection with Development programme is by itself an inflationary force, in as much as 80 per cent. of the expenditure (e.g., those on basic industries, power, road, irrigation etc.) relates to the production of non-consumer goods. As such it will put into the economic system a colossal amount of money with inflationary effect thereof on commodity prices. Deficit financing also adds to this inflationary process, unless the tax measures are so contrived as to mop up the small funds of additional income flowing into the hands of people in general. The contrary attempt to draw revenue by confiscatory levies on an infinitesimally small section of the people and on organised business is not only ineffectual as an anti-inflationary measure, but the process has within itself the germs of cost inflation, the malady which afflicts the system today.

In our opinion, public expenditure can greatly help in moderating the forces of inflation, if (a) economy and rationalisation in public expenditure are practised, (b) 'uneconomic' expenditure, wastages and leaks are eliminated, and (c) the size of the Five Year Plan be cut down to the urgent needs of the country and confined to measures that will result in a larger production of consumer goods immediately, to absorb the large volume of inflationary money that the Plan will release. Further we are of the opinion that public capital expenditure should be timed in relation to economic fluctuations.

In this connection we would like to draw the attention of the Commission to the following observations of the League of Nations Delegation on Economic Depressions: "It should be the object of the Government to dovetail its demand—in fact its public works—into the zig-zag of consumers' demand. In order to do this, it will require to have a general plan carefully elaborated in advance. It should know what it wants to do not next year or the year after only, but over a period of five or ten years. It should have the individual projects that fit into the general plan worked out in considerable detail; those that are likely to prove the most urgent; it should attempt to classify these projects according to the degree of urgency, to the period required for their execution, according to locality, to the type of labour skills required etc. It should be ready to start on one or another of these projects with the greatest possible promptitude as circumstances demand, and at the same time it should be prepared to postpone putting projects into execution". (The Transition from War to Peace Economy, League of Nations, 1943, pp. 62-63).

Question 44.—See answer to Question No. 43. High imposts on business in general are a contributory factor in raising the cost of production of our goods. The high prices are today being resisted by consumers, and this has created a situation of business instability in this country. Further the high export duties have also rendered our goods unsaleable abroad. So in the present price structure tax changes are necessary to bring down the cost of production and make our goods saleable both at home and abroad.

Question 45.—As stated in our preliminary memorandum on the subject the present situation should be correctly assessed as a situation of "cost-inflation", and as such remedies suggested under Question 44 and *ante* should be taken resort to.

EMPLOYERS' ASSOCIATION, CALCUTTA

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

PART I—THE TAX SYSTEM

GENERAL.

Question No. 1.—What, in your opinion, should be the objectives of a sound tax policy? What should be the place in such a policy of the following objectives:

- (a) *reduction in inequalities of income and wealth;*
- (b) *encouragement of incentives to work, to save and to invest;*
- (c) *countering of inflationary and deflationary tendencies; and*
- (d) *maintenance of the external balance of the economy?*

In what directions would you suggest modification of the Indian tax system having regard to these objectives?

The objectives of a sound tax policy, in the present context of the Indian economy, should be to provide the maximum incentive to the tax-payers in order to ensure the creation of additional wealth on a large-scale in as a short period as possible. As there will have to be intensive development of industry and agriculture and the emphasis will always have to be on stepping up productive expenditure as far as possible, for a considerable time to come, the tax machinery should be conceived in such a way that the greatest encouragement is given to work, save and invest. It is only after a substantial increase in the national income and wealth has been brought about that any effort could be made to bring about a reduction in inequalities of income and wealth. Actually, accumulated wealth in particular directions has been truly responsible for promoting development of trade and industry and the conditions that obtain in this country now are very peculiar. Also, any immediate attempt at reducing inequalities of income and wealth drastically will mean only distribution of poverty and will seriously retard the impressive progress that is being made in the private sector.

The tax machinery has, no doubt, a place in countering inflationary and deflationary tendencies. The use of the instrument of taxation can, however, be exaggerated as happened in the case of the jute industry with the levy of fantastic export duties. Taxation can probably play an important part in the maintenance of the external balance of the economy though the formulation of a proper fiscal policy is necessary for this purpose. It is imperative, however, to take note of the basic needs of the economy and place reliance on methods other than taxation for countering inflationary and deflationary tendencies. Taxes after all, like controls, can only act as palliatives. Positive measures will have to be adopted in appropriate fields in order to get over inflationary tendencies to bring about increased production or otherwise and step up total expenditure and create additional demand for surplus production, etc., to meet deflationary situations.

It follows, therefore, that the tax structure should be realigned in such a way that all the above objectives are secured.

In our memorandum submitted to the Commission last June, we emphasised forcefully the need for redistribution of the existing tax burden and refraining from the adoption of new measures which will have a disturbing effect on the economic and social structure. In short, the estate duty bill, which has recently been passed by Parliament would have a discouraging effect on capital formation and ought not to have been brought in at this stage. This new measure would create difficulties if, as a result of unforeseen developments, the bigger industrial groups are obliged to pay large sums towards the estate duties and there is consequent break up of the industrial set up. It has also been pointed out that, in the name of inflation or deflation, particularly the former, adequate note has not been taken of the effects of indirect taxes, particularly the export duties. The Exchequer, no doubt, benefited by the unexpectedly large increase in receipts from export duties. But the higher prices have had a damaging effect in some cases permanently and overseas markets have been lost. This is true of the coal and jute industries. Even though it has been suggested that, in the case of the jute industry, the high export duties kept down raw material prices the profit margin of the industry was affected. The incidence of the full duty was not passed on to

the consumer of the finished product or the grower of the raw material.

An analysis of the profits of important jute mills indicates clearly that even normal profits could not be earned in 1947-52. In fact, the earnings in particular periods were not sufficient for providing regular depreciation and prior charges. Only the Government earned substantial sums. In respect of the coal industry also surcharges were levied and with the increase in costs of production the collieries did not derive any reasonable profits from export sales.

The provision of incentive to work, save and invest is thus badly necessary. Both individuals and corporations have a very important part to play in the development of the Indian economy. The Central and State Governments are trying to appropriate for themselves a much larger part of the national savings than is justified and it has now become very clear that due to the lop-sided development of the public sector, the private sector has been deprived of the requisite resources and the expected rate of development has not been found possible. Direct taxes should be reduced as far as possible and through increased collections from indirect taxes there should be a serious effort to obtain a larger coverage especially in the rural side. The corporate sector should be helped to discharge its responsibilities fully. Capital formation has been very meagre and the rehabilitation programme has been held up due to the lack of adequate resources. The established industries have been finding it difficult to replace worn-out plant and machinery. Unless depreciation allowances are granted on the basis of replacement costs, in some agreed manner, it will be difficult to maintain the present rate of production and increase efficiency. It is very necessary to carry out the rehabilitation programme on a defined basis. It is also important that tax relief in respect of profits which are ploughed back should be given. As regards personal incomes, in order to encourage earnings and canalise savings it is desirable to exempt from tax investments in approved industrial undertakings. Private building construction should also be encouraged through the grant of depreciation allowances. At present only a part of the expenses incurred on maintenance is allowed. A higher percentage of income should also be allowed to be paid by way of insurance premia while special allowances to income-tax payers on the model of the U. K. must be given.

Question No. 2.—What criteria would you suggest for determining the equity of a tax system? How far is it possible to secure it in the Indian tax system?

The criteria for determining the equity of the tax system differ from country to country though in principle there cannot be much difference, given the same economic ideals. The Indian tax system, however, both of the Centre and the States, has grown in an undefined manner and not much attention has been paid to equitable distribution of the total burden. With the result, even the Planning Commission has observed that the urban population is paying a larger percentage of the taxes than the rural population. Even though 40 per cent. of the total expenditure under the Five Year Plan is found from current revenues and the benefit is mostly derived by the rural areas, the tax system has not been readjusted so as to bring in larger revenues from the countryside and make the average citizen pay to a greater extent in the shape of taxes towards development expenditure, the benefit of which would be derived by him or his heirs.

It is difficult to assess correctly the incidence of direct and indirect taxes. But the middle class population has been unduly oppressed and agricultural incomes have not been taxed as correctly as they should be. Every effort should, therefore, be made to lighten the burden of direct and indirect taxes levied by the Centre.

Land taxes should be raised and betterment fees levied so that the Exchequer will still get the revenues it desires while the necessary relief is afforded to those sections of society which are badly oppressed.

Having regard to the relatively backward nature of our economy and the very small section of the population paying direct taxes, the tax system, as at present conceived, is no doubt inequitable. In respect of the higher income groups particularly the rate of progression is so severe that the incentive to earn is seriously

discouraged. Taxes are among the highest in the world. But even in the U. S. A., Canada and Australia such

oppressive rates are not levied. evident from the figures given below.

TABLE I

Percentage of Income and Super-tax on selected typical incomes (all earned) in the case of with 2 children in India, U. K. and U.S.A.

Income Rs.	India 1953-54	U. S. A.* 1952	Australia 1952-53	U. K. 1953-54
25,000	13.2	12.1	22.0	20.0
50,000	30.9	18.1	37.1	39.5
1,00,000	50.1	25.6	53.2	56.0
2,00,000	65.2	38.1	64.0	72.1
5,00,000	75.3	57.0	70.6	85.8
10,00,000	78.7	70.1	72.8	90.3
20,00,000	80.3	80.4	73.9	92.7

* Split Income Basis.

N.B.—The incidence of taxation will be even less in the case of U. K., U. S. A. and A benefits accruing on account of medical, maternity and other allowances are taken.

Question No. 3.—Does the Indian tax system conform adequately to the principle of ability to pay or do you think an extension of this principle is desirable and practicable? If so, in what ways?

The answer to this question is partly given in (2). The extension of this principle is desirable and practicable in the States' sphere.

Question No. 4.—Differing views have been expressed on the extent to which the taxable capacity of various sections of the community has been used by the Indian tax system. What is your view on the subject?

There has been no serious effort to determine the taxable capacity of the community, not to speak of the

various sections of the community income and super-tax rates has been such as to have a retarding effect. The high rates have obviously for the extraction of large sums from the higher income groups. Over a percentage of retained income has declined and the tax reliefs in 194 any way helpful. Even though the above Rs. 2 lakhs are accounting for 1 of the total assessed income, the 1951-52 were as much 23.31 per cent. in regard to the actual incidence amounts paid were 37.63 per cent. while in 1951-52 they were as much. The figures are given below:—

TABLE II

Showing distribution of incomes in 1940-41 to 1951-52 and the incidence of tax in each

	Number	1440-41	
		Income (In thousands of Rs.)	Tax
Up to 25,000	262,404	121,55,90	6,00,27
25,001—100,000	7,727	24,32,93	4,04,33
100,001—200,000	391	4,69,62	1,30,51
200,001 & over	190	7,48,31	2,81,57
TOTAL	270,712	158,06,76	14,16,68
Up to 25,000	482,258	369,23,28	1951-52 26,07,20
25,001—100,000	34,051	138,93,55	36,58,48
100,001—200,000	1,981	26,48,53	14,46,18
200,001 & over	839	35,55,80	26,06,94
TOTAL	519,129	570,21,16	102,98,80

Question No. 5.—The proportion of tax revenue to national income in India is considered small relatively to several other countries. Do you think this proportion can be raised, and, if so, what tax changes would you suggest for the purpose?

The proportion of tax revenue to national income in India is stated to be small relatively to several other countries. This observation has been made because there is a disposition to reckon tax revenue collected as a percentage of national income and not national savings. It is true that in the U. K., U. S. A., Canada and Australia the proportion of tax revenue to national income is over 25 per cent. and as much as 35 per cent. in particular cases against only 7 per cent. in this country. This comparison is, however, inaccurate as indicated above. The tax revenue should have relation

would be correct, therefore, to state that it should be expressed as a proportion to national income.

If this criterion is adopted it will be seen that the proportion of tax revenue to national income is high as 60 per cent. on the assumption that the present moment is a time of national income and that the amount of savings are about Rs. 650 crores. It means that gross savings of 12 per cent., 7 per cent. and taxes are nearly 60 per cent. of national income is about £12,000 million. The savings amount to £4,000 million. The savings are over 15 per cent. or about £2,000 million. To net savings there is a gross amount of £4,000 million. The percentage of taxes to gross savings is about 15 per cent.

therefore, that the burden of taxation in this country is not calculated to the advantage of its economy and that the methods adopted in the advanced countries are copies without any regard for the consequential effects.

Also in a country where the *per capita* income is low and the tax paying section is a fraction of the total population it is incorrect to express taxes as a proportion of national income. If this must be done account must be taken only of the income of that section of the community which pays taxes.

It would then be found that even to secure the same revenues there will have to be greater spread through increasing reliance on indirect taxes. Otherwise, constructive forces will receive a rude check and it will not be possible to increase the taxable capacity and raise the percentage of tax revenues to the national income at a later stage if it is felt necessary. It is, therefore, of the utmost importance to take account of the special conditions in this country.

Question No. 6.—Do you think that the relative place of direct and indirect taxes in the Indian tax system is satisfactory?

The relative place of direct and indirect taxes is not satisfactory. As will be evident from the figures below the proportion of direct tax revenue to total tax revenue has increased in the past decade and a half. The Planning Commission has itself admitted that the tax burden is impinging on a very small section of the community. In view, therefore, of the need for a larger section of the population to contribute towards developmental expenditure particularly and giving relief to those who are now oppressed by direct taxes, the only means of realising the amounts would be through indirect taxes levied lightly on essential articles of consumption in their finished state. Any attempt to fix an arbitrary ratio between direct and indirect taxes will create great hardship. The attempt should always be to levy as many taxes as possible affecting the rural sector till such time there is an increase in the volume of personal and corporate incomes eligible for income and super taxes.

TABLE III

SHOWING THE PROPORTION OF DIRECT AND INDIRECT TAXES TO TOTAL TAXES OF THE CENTRE.

	1937-38	Percentages		1952-53 (Revised)
		1945-46	1948-49	
Import duties	53.47	23.12	27.16	27.96
Export duties*	5.62	1.20	7.34	12.93
Land customs and Misc.	0.80	0.40	1.56	1.11
Total customs	59.89	24.72	36.06	42.00
Less refunds	1.94	0.64	0.78	0.76
Net customs	57.95	24.08	35.28	41.24
Excise	10.71	15.14	14.30	18.64
Salt	10.62	3.27	..	..
Other indirect taxes	0.67	0.31	0.17	0.50
Total indirect taxes	79.95	42.80	49.75	60.38
Corporation tax	2.38	26.93	17.21	9.28
Taxes on income other than C. T. F.*	17.67	30.27	33.04	30.34
Total direct taxes	20.05	57.20	50.25	39.62
Total taxes	100.00	100.00	100.00	100.00

* Including States' Share.

The table given above clearly shows the increase in the burden on account of direct taxes. When E. P. T. was levied the percentage of revenue of direct taxes to the total tax revenue was at its highest. Even though there has been a decline, direct taxes are still bringing a larger share of the revenue. A return to the pre-war pattern is no doubt desirable.

Question No. 7.—Do you consider that non-tax revenues are likely, in future, to occupy a more important place than hitherto in the public revenues of India? If so, please state the sources of non-tax revenue you have in view and indicate to what extent they may be expected to contribute to the public exchequer.

Non-tax revenues are likely, in future, to occupy a more important place than hitherto in the public revenues of India. Even now there is great scope for increasing income through a better utilisation of forest and mineral resources. The policy of many States in regard to afforestation and utilisation of forest produce and improvement of transport facilities is not exactly helpful. In regard to exploitation of mineral resources also the State Governments have been unhelpful and measures have been adopted in such a way that the objectives of the Central Government are not furthered. Also, it is expected that the large-scale expenditure under the various multipurpose projects would lead to the growth of large non-tax revenues. In order to be sure about substantial revenues the Government must adopt practical policies and take care that available resources are utilised effectively and remuneratively.

Question No. 8.—Do you agree with the view that receipts from particular taxes should not, as a rule, be funded or ear-marked for specific purposes?

Normally, receipts from particular taxes should not be funded or earmarked for specific purposes. In particular cases, however, it would be desirable to ear-

mark definite proportions of the receipts for expenditure in specified directions. It has been contended for a long time that the receipts through the various taxes levied both by the Centre and States from the users of cars and trucks have been utilised for purposes other than the development of roads. There has, naturally, been a demand that a good proportion of the sums realised from the users of cars and trucks should be set aside for the construction of more and better roads. We have also indicated that, in the case of export duties, the time lag in making the necessary adjustments in rates has meant hardships for the industries and trades concerned. Where the duties are levied at prohibitive rates under exceptional conditions, there should be an arrangement for funding part of the proceeds for the benefit of the industries concerned, in times of difficulty. This procedure has been adopted in Sweden and elsewhere.

Question No. 9.—Do you think that it is desirable, under certain conditions, to levy cesses for special purposes?

It is desirable, under certain conditions, to levy cesses for special purposes. A number of them are already being collected at the present moment particularly in the States' sphere. The cess on tea, shellac, coffee and others levied by the Central Government are fulfilling a definite function and the industries concerned benefit in some way. But the proceeds are not always applied for the intended purposes. It has been pointed out in the case of the cess on sugarcane that the large sums collected by way of cesses are utilised for other purposes and that there has been no anxiety to improve cane cultivation and raise the yield. The same difficulty is experienced in regard to the land cess as well.

Question No. 10.—State undertakings, commercial, industrial, etc., are coming to play an increasingly important part in the economy of the country.

Have you, from the point of view of their significance as a source of revenue, actual or potential, any comments or suggestions to make on matters such as the further extension of State undertakings and their policies in regard to pricing, in so far as these may be relevant to tax policy?

State undertakings, commercial, industrial and otherwise, should not play an increasingly important part in the economy of the country. For such of those State industrial undertakings already in operation, the Government should formulate a uniform policy with regard to pricing if only to avoid unfair competition with the private sector. It has been suggested very often that State undertakings, industrial or commercial, should be run on the basis that they pay taxes to the Government in the same way as private enterprises and that no preferential treatment is accorded to the Government enterprises. In view of the confusion in this regard and the relatively smaller return on investment in State undertakings it would be advantageous from the point of view of the Government to extent the activities of the private industrial sector instead of the Government themselves assuming additional responsibilities in an important transitional phase.

Question No. 11.—Would you suggest that the net surplus earned by State undertakings should accrue to general revenues or be carried to a fund for financing projects of development or be re-invested in the undertakings concerned?

The net surplus earned by State undertakings should accrue to general revenues to the extent taxes are payable. It is for this purpose that the principle of joint-stock company accounting has been recommended. The surplus left over after the payment of the legitimate share of taxes could be reinvested in the State undertakings concerned or if the funds are not immediately required they should be handed over to general revenues.

Incidence of Taxation.

Question No. 12.—In examining the incidence of taxation in various classes of people, which of the following factors, singly or in combination, would you suggest as the basis of differentiation—

- (a) income,*
- (b) occupation,*
- (c) rural or urban residence?*

Is there any other basis which may be considered?

The incidence of taxes on various classes of people has to be considered in combination and not singly as there is already a feeling that the particular disabilities suffered by some classes of tax-payers are not given any special consideration and that the absence of facilities for averaging earnings or otherwise has led to the payment of taxes on an inequitable basis. Income, however, will have to be given special importance. When considering the assessment of incomes, the nature of occupation has also to be considered. It has also been pointed out that the levy of agricultural income-tax has not been done effectively or on a uniform basis and that for income-tax purposes agricultural and non-agricultural incomes could be aggregated. There are some special difficulties, specially constitutional, in this regard. Besides, any aggregation of incomes will only result in a heavier burden on those who are already paying income and super taxes. It should, however, be possible in some way to differentiate for income-tax purposes between rural and urban residence.

Question No. 13.—Do you think that the burden of the present tax system—Central, State and Local—is fairly distributed among—

- (a) various classes of people?*
- (b) different States?*

The incidence of taxation, Central, State and Local is not fairly distributed especially as State taxes vary greatly in incidence. In regard to land taxes particularly there is considerable discrepancy between the various States, while the sales tax has different incidence when it happens to be multipoint or single point. The rates also are varying.

As regards the incidence of taxation on the various classes of people, the worst affected are those paying direct and indirect taxes and resident urban areas. The agricultural income groups are not pulling their full weight. Out of the total taxes of about Rs. 650 crores, approximately Rs. 520 crores are paid by the urban population who constitute 20 per cent. of the total population and Rs. 130 crores by the rural population who constitute 80 per cent. of the total population. Thus, 80 per cent. rural population contributes 1.4 per cent. in the shape of taxes to the Government and 20 per cent. urban population the remaining 5.6 per cent. The rural and urban populations earn 60 per cent. and 40 per cent. of the national income respectively. On this basis, the rural population contributes 2.5 per cent. of its income in the shape of taxes while the urban population contributes as much as 14.4 per cent. of its income towards taxes. The main brunt of taxation, therefore, falls on a very small segment of the population.

Question No. 14.—Have shifts in the distribution of income in the community in recent years altered the relative incidence of taxation on various classes of people? If so, to what extent?

While the incidence of taxation is generally uneven and particularly oppressive on urban residents, the recent shifts in income from the urban to the rural areas have complicated matters. There will, therefore, have to be as explained in answer to Question 13 a definite increase in the burden of taxation on rural incomes.

Question No. 15.—Do you think that the cost of compliance with tax regulations adds materially to the burden of taxation? If so, in respect of what taxes? Please give details.

There is no doubt that the cost of compliance with tax regulations adds materially to the burden of taxation. In regard to income-tax and sales tax particularly the wrangling with the departmental authorities and the delay in assessments have necessitated the maintenance of accounts in an elaborate form and the employment of specially qualified experts. The need for contesting official decisions results also in considerable expenditure. If official procedure could be simplified and there is greater understanding of the difficulties of assessee, the cost of compliance could be very much less.

Besides, when rules and regulations regarding tax payments are framed only the cost of collection is taken into consideration. No account is taken of the cost of compliance with tax regulations, from the assessee's standpoint. It is necessary to remember that social waste should be avoided as far as possible, and that the total cost from the point of view of community, i.e., the cost of collection as well as the cost of compliance, should be taken into account in order to find out whether the additional revenue would be worthwhile.

Even in regard to indirect taxes like excise, customs, etc., the advantages in regard to drawback or otherwise are to a great extent neutralised because of official delays. The maintenance of numerous forms, returns, etc., also adds to work and cost.

Question No. 16.—Do the benefits accruing from public expenditure have a bearing on a consideration of the burden of taxation? If so, how would you take this into account in considering the burden of Indian taxation?

The benefits accruing from public expenditure have a bearing on a consideration of the burden of taxation. The expenditure incurred by Government for provision of educational and medical facilities have benefited largely the rural population in the States' sphere. The benefits derived by the urban population, however, are not commensurate with the taxes paid by them. Besides, in the context of present conditions and with the accent on developmental expenditure, both at the Centre and in the States, it is important to remember that the benefits accruing are of a more permanent nature. The rural population should, therefore, be educated about the benefits that will accrue as a result of the large-scale developmental expenditure under the Five Year Plan. About Rs. 1,200 crores will be spent on the agricultural and community projects, irrigation and power projects, social services, road development, etc., in the rural areas. This will be found through tax revenues to the extent of nearly 40 per cent. or Rs. 480 crores. It stands, therefore, to reason that the rural population should bear a portion of this expenditure, say Rs. 100 crores a year, in the shape of new taxes apart from contributing their share towards the normal expenses of Government.

Question No. 17.—Do you think that the tax burden weighs particularly heavily on any individual industry or occupation? If so, please furnish the Commission with the evidence on which you rely.

In recent years, the levy of export duties on the jute, tea and cotton textile industries, particularly the former two, has had a regressive effect. The experience of the jute industry shows that even though raw material prices were depressed on account of the export duties the incidence of the duty was not passed on fully either to the grower of jute or the consumer of jute manufactures. In the bargain, the jute industry has done very badly since the partition and it has been necessary to draw on reserves in particular periods even for providing depreciation, paying token dividends and wiping out losses.

Taxation and Economic Development.

Question No. 18.—What role would you assign to taxation vis-a-vis various types of borrowing in finding the additional resources required for the development programme of the country?

The place of taxation vis-a-vis various types of borrowing in finding the additional resources required for the development programme of the country increases or decreases in importance with the nature of developmental expenditure incurred. Where a large section of the community is benefited and planning has been done on scientific lines it is certainly justifiable to find additional resources through taxation. But in actual practice

it has been found that the benefits of developmental expenditure have not been uniformly derived and that particular sections paying taxes are discontented. It will be far more appropriate if in the case of specific industrial undertakings or developmental expenditure which will benefit particular areas, borrowing on a larger scale is resorted to and the present generation is not obliged to pay heavily for the sake of posterity. Actually, developmental expenditure should be met mostly from borrowings while non-developmental expenditure only can be charged to revenues.

Question No. 19.—*In maximising the resources required for the financing of development, what degree of importance would you assign to :*

- (a) economy and rationalisation in expenditure,
- (b) prevention of tax avoidance and tax evasion,
- (c) higher rates of existing taxes,
- (d) fresh taxes,
- (e) development of non-tax revenues ?

We have already stated that development expenditure should be financed as far as possible through borrowing. There is need nevertheless for economy in and rationalisation of Government expenditure as a good part of the cost of administration could be avoided and there is an increasing tendency in recent years for the total expenditure to increase. If substantial economies could be effected there could be relief under taxes. Tax avoidance and evasion are noticeably present only because of the high rates of taxation. Lower tax rates do not mean necessarily loss of revenue. Actually, they might ultimately result in larger revenues. If, in the interim period, additional resources have to be secured receipts from indirect taxes will have to be increased and new taxes like the betterment fees will have to be levied and the salt duty reintroduced. As regards (e) we have already indicated except in regard to the development of non-tax revenues from sources like forest produce, Government owned plantations, multipurpose projects, etc., there should be no attempt to encroach into the sphere of the private sector.

Question No. 20.—*Under the Five Year Plan the public sector is expected to undertake a larger investment: an important place is also assigned to the private sector in the development programme. How would you advise a tax policy suitable in the development programme of the country in both sectors ?*

It is not expected that the public sector will have any large difficulty in finding its requisite resources, especially as it can have recourse to deficit financing. Besides, a large proportion of available free savings is being appropriated for expenditure in the public sector and very little has been left for others. Capital formation in the private sector is rather poor and it has been repeatedly pointed out by us that positive concessions should be made to augment available resources and that, apart from a reduction in corporate taxes and the grant of a tax free depreciation allowances to established industries, in order to complete their programme of rehabilitation, non-corporate assessees will have to be encouraged to invest in approved industrial undertakings by exempting investments up to a particular limit made out of current income. Other incentives also should be offered as indicated at the beginning.

These suggestions will not, in any way, conflict with the interests of the Central Governments as any loss will be only temporary and with an increase in industrial activity more revenue could be collected even with lower taxes.

Question No. 22.—(i) *Is there evidence for the view that the rate of private capital formation in the community has been lower in the last few years as compared to the pre-war period ? What factors, in your opinion, account for the decline ?*

(ii) *Has there been a shift in recent years in the sources of capital formation in the private sector as between individuals corporations and other institutions ?*

(i) No definite evidence is available for the view that the rate of private capital formation in the community has been lower in the last few years as compared to the pre-war period. The Fiscal Commission has pointed out in their report that "no comparable figures of savings are available for the post-war years but one unofficial estimate based on admittedly inadequate data suggests the actual emergence of dissavings in the year 1946-57 and 1947-48 followed by a negligible amount of savings in 1948-49, when the rate of savings was stated to be as low as 1.4 per cent. We cannot accept the correctness of these views. But there can be no doubt about post-war trends in general—that the rate of capital formation has declined. There must be a great national effort to recover the ground lost in these years and attain levels of saving comparable to those of the pre-war years"

Apart from these observations of the Fiscal Commission, it can be reasonably stated that the middle income groups who have been and are the backbone of the organized capital market by taking out insurance

policies, by depositing funds with the banks, by investing in stocks and shares, etc., have been badly affected by the accentuation of inflationary forces and the imposition of heavy indirect and direct taxes. New capital issues in recent years have been on a considerably smaller scale while the stock markets have been languishing. Even with the availability of higher yields on first class preference shares there is no buying by middle class investors. In regard to the private industrial sector we have already pointed out in our study entitled "Depreciation Allowances and Replacement Costs" that capital formation in the corporate sector has been negligible and that major industries like jute, coal, sugar and cement were earning a level of profits which did not even admit of the provision of normal depreciation charges, payment of decent dividends, etc. No emphasis is, however, made here on the real rate of capital formation in the established sector as the question of provision of finance for replacement of worn-out plant and machinery installed at pre-war prices is being considered separately.

The lower rate of capital formation, it is needless to add, is due to the levy of fantastic export duties in the case of the jute industry, the imposition of a heavy surcharge on coal exports and fixation of uneconomic prices and wrong price-fixation policies in the case of sugar and cement, etc. The bonus awards and the heavy inflation of the cost structure due to the spate of labour legislation in recent years have also contributed to a reduction in net earnings.

(ii) There has been a shift in recent years in the sources of capital formation in the private sector. The shift in incomes from the urban to the rural areas, consequent on the higher prices for agricultural produce, has led to a dispersal of savings and even promoted expenditure on consumption. Even so, there is ample evidence regarding the presence of savings in the countryside with the increasing response for the small savings campaign and the unexpected subscriptions from agricultural income groups to the State loans floated recently. On the other side, middle class savings, where they exist, have been reflected to a greater extent in the increasing assets of insurance companies.

Question No. 23.—*Do you think that tax relief in respect of persons in the middle-income group would assist the growth of savings or mainly promote consumption ?*

The answer to this question is both in the negative and affirmative. To the extent distress is experienced by the increased cost of living, sums released on account of tax reductions will promote consumption in the lower income groups. This will be, however, beneficial in the long run. There are, however, particular income groups between Rs. 15,000 to Rs. 75,000 who have grown vastly in importance and who are anxious to save. Any tax relief which will be beneficial to the middle classes will, therefore, assist the growth of savings.

Question No. 24.—*The Planning Commission have given an estimate of the rate of progress in regard to national income and consumption standards on the assumption of 50 per cent. of the additional output going into investment each year after 1956-57. What measures in the field of taxation are necessary if this assumption is to be realised ?*

The Planning Commission has stated that capital formation from out of domestic resources should be raised by 50 per cent. in the course of 1951-56, i.e., from about Rs. 450 crores in 1950-51 to Rs. 675 crores by 1955-56 which would in effect be taking away about half of what is left over from the increase in the national product for raising standards of living. When this question was discussed at the meeting of the Planning Commission Advisory Board in October last, the need for evolving a machinery which will mobilise fresh savings was pointed out. The increase in the gross national product will come about in such a way that savings will be widespread, especially in the rural areas. Taxation of a kind, mostly indirect, will help to mobilise a portion of the new savings. But the taxation policy should be such that it does not affect the classes who are already oppressed. It may be necessary, however, to broaden the basis of the credit structure and attach greater importance to the small savings campaign.

Question No. 25.—*Do you accept the view that some regulation of consumption standards is desirable as a means of releasing larger resources for development ? If so, what part, in your view, can tax policy play in this process and what should be the relative role of direct and indirect taxes in achieving the purpose ?*

The need for regulation of consumption standards is not desirable because it is already low and the conditions anticipated by the orthodox school that inflationary pressures released by the Five Year Plan needing regulation of consumption may not materialise. Besides, no fresh hardship can be endured by the general population who are already on a semi-starvation basis.

Question No. 26.—*How far can tax policy help to promote the efficiency of the productive system ? Do*

you think that multiplicity of taxes in India in respect of the same commodities and their lack of uniformity from State to State affect the allocation of resources in the community and hence the efficiency of the economy? Have you any suggestions for the rationalisation of the country's tax structure in these respects?

Tax policy can promote considerably the efficiency of the productive system. This observation is amply borne out by the plea put forward by the private industrial sector for additional depreciation allowances on a tax-free basis and lower corporate taxes in order that the efficiency of plant and machinery can be raised by effective rehabilitation. Also, the administration of the sales tax and taxes on raw materials have resulted in a restriction of inter-State trade and unnecessary inflation of costs of production. We have already pointed out that sales tax on industrial raw materials should not be levied while the administration of the sales tax should be centrally guided and uniformity in levies should be ensured as far as possible.

Question No. 27.—How far in your view could the tax system could be used to secure any order of priorities in the development programme in the private sector?

The tax system could be used to secure a given order of priorities, only with a positive approach, in the development programme in the private sector by exempting from payment of income-tax for a longer period than now allowed for new industrial undertakings. It may also be stated that investments out of current income will be exempted from payment of income-tax, on a special basis, if they are made in specified industries. In effect, the concession offered now to the corporate bodies in respect of inter-company investments should be extended to the private investor as well. But the instrument of taxation should not have a penal effect and no effort should be made to determine priorities in this manner.

Question No. 28.—What are the possibilities and limitations of tax policy as an instrument for economic development:

- (a) by influencing over-all demand,
- (b) by reducing consumption and unessential investment,
- (c) by positive inducements for desirable investment,
- (d) by redistribution of incomes,
- (e) in other ways?

Taxation can be used as an instrument to influence overall demand especially as it has been suggested that some of the indirect taxes have added to costs and have had an inflationary effect. When consumption standards have increased to a desirable level and on account of a high level of production available resources are utilised for purposes other than absolutely essential, taxation policy could be utilised for reducing consumption and cutting out unnecessary investment. In the context of existing economic conditions, however, it will not be advisable to bring about a drastic redistribution of incomes though the principle of progressive taxation has, in fact, brought about some redistribution. What is necessary, however, is to create scope for earning more incomes. The possibilities of tax policy as an instrument for economic development have been indicated to a certain extent under answer to Question No. 26.

Question No. 29.—How would you assess the scope and efficacy of tax policy as compared to monetary policy and direct controls as an instrument of planned economic development in India?

The scope and efficacy of taxation policy as compared to monetary policy and direct controls as an instrument for planned economic development in India is limited though a good deal will be achieved by careful adjustments and reliefs for furthering the development of the private industrial sector. We are opposed, however, to direct controls while monetary policy should not result in creating undue restriction of credit or increase in cost of borrowing.

Question No. 30.—Do you think that the present tax system in India makes for a reduction in inequalities of income and wealth?

So far as direct taxes are concerned the incidence is very heavy on the higher income groups and a study of the income-tax revenue statistics furnished by the Central Board of Revenue shows that there has been an increase in the number and average income of the assesses in particular groups, with a reduction in the very high income groups. The progression in the rates of tax should be less steep as reduction in inequality of incomes cannot be attempted at this stage.

Question No. 31.—What modifications in the tax system would you suggest for securing a larger degree of economic equality, consistently with maintaining the incentives to capital formation and higher production?

We are generally opposed to any attempt aiming at a drastic reduction in the inequality of incomes.

Question No. 32.—What place would you assign to public expenditure as compared with the tax system in achieving a greater measure of equality of income?

It cannot be definitely said that increased public expenditure as compared with the tax system can achieve a greater measure of equality of income except that such public expenditure is found through increased tax revenues which can have a regressive effect on certain sections of society. The same objective could be achieved if the level of general expenditure is stepped up and through increased scope for employment and generating incomes a more constructive approach is adopted. Then, instead of levelling down incomes a situation could be brought about by which incomes are levelled upwards. Better results could probably be achieved if the private sector can increase the tempo of activity. The objective should be to raise total expenditure and not merely public expenditure as it is very often found that there will be more effective utilisation of available resources if they are made available to the private sector.

Question No. 33.—Have you any changes to recommend in tax policy in relation to the investment of foreign capital in India?

There is no case for preferential treatment to be accorded to the investment of foreign capital in India. It is necessary, however, to ensure that the passing of legislation like the Estate Duty Act does not lead to disinvestment and that the policy of taxing dividends at source does not involve undue hardship.

Question No. 34.—Article 269 of the Constitution enumerates the following taxes which may be levied and collected by the Union but the proceeds of which are to be assigned to the States:

- (a) duties in respect of succession to property other than agricultural land;
- (b) estate duty in respect of property other than agricultural land;
- (c) terminal taxes on goods or passengers carried by railway, sea or air;
- (d) taxes on railway fares and freights;
- (e) taxes other than stamp duties on transactions in stock exchanges and futures markets;
- (f) taxes on the sale or purchase of newspapers and on advertisements published therein.

How do you assess the possibilities of adding to country's tax resources in respect of the above items?

In regard to (a) and (b) the duties in respect of succession to property other than agricultural land and estate duty in respect of property other than agricultural land mean only a transference of resources from one to another, namely from the private sector to the Exchequer. It is our considered opinion that, in the context of the present conditions, such transference would prove to be unhealthy as available resources are now being put to effective use and industrial development has been greatly aided. Terminal taxes on goods or passengers carried by railway, sea or air are now being collected for providing funds for the local bodies. In our view, the whole question of local taxation should be considered in a different light and there should not be any attempt to penalise the urban citizens to any great extent in this way. As regards taxes on railway fares and freights, in the U. S. a large revenue is derived. In this country there is already some form of indirect taxation as it is complained that passenger fares and freight rates have been unnecessarily increased and railways are earning large surpluses. In fact, considerable sums could be found by way of economics. Besides, in view of the fact that railways have been nationalised and their surplus resources could be had in some form or other for the use of the Central Government, there is no justification for emulating the example of the U. S. In that country, railways are under private management. Taxes other than stamp duties on transactions in stock exchanges and futures markets can bring in large revenues only when the economy is more developed and business passing is on a very much large scale. Any attempt to raise additional resources from this direction at the present moment would only stultify activity and defeat the objectives. The same argument holds good for taxes on the sale or purchase of newspapers and on the advertisements published therein.

Question No. 35.—Other possible ways of adding to tax receipts which have been suggested are taxes on capital, reintroduction of the salt duty, surcharges on land revenue, betterment levies, agricultural income-tax, social security taxes and modification of the policy of prohibition having regard to the directive principles of the Constitution. What are your views regarding the desirability and the probable scope of each of these forms of taxation?

We have already explained in detail in our memorandum submitted to you that the salt duty should be reintroduced and in fact should be made to yield a larger sum with the definite proviso that the proceeds from the duties should be applied for development pur-

poses. Surcharges on land taxes are overdue as the revenue from this source has been more or less static in the past decade and a half and there has been no attempt on the part of the Government to secure larger revenues even though agricultural incomes have increased significantly and the higher level of prices for agricultural produce has been greatly advantageous to the cultivator. Besides, it will be worthwhile to find out whether uniformity in the levy of land tax could be ensured. While the incidence of land taxation is low even in Madras and Bombay it is very much lower in other States. As regards betterment levies there cannot be any hesitation as the land-owner in the areas where the multi-purpose projects will start functioning will benefit greatly and it is stated that there have been already a sharp appreciation in land values. The betterment levies should be properly conceived and enforced. There is scope for a large income from this source. As regards the modification of policy for prohibition a practical approach is to be adopted. Even in Madras where it has been claimed that the policy of prohibition has been completely successful there is a demand for modification. There should be no taxes on capital gains other than betterment fees and no social security taxes.

Question No. 36.—Do you consider it desirable and feasible to levy a tax on unearned increments in value of land and other property as a result of public projects of development?

This question has been partly answered by the reference to betterment levies in the previous paragraph. It is probably difficult to levy a tax on unearned increments in value of property other than land as a result of public projects of development as the benefit of appreciation may not be tangible. In the case of unearned increments in value of land, however, the Government should ensure that they get a fair share on first sale.

Question No. 37.—What measures would you suggest for increasing the receipts from existing sources of revenue?

Rigorous assessments by the income-tax and sales tax departments by themselves yield larger revenues. For this purpose, the personnel of the income-tax department should be further increased. Instructions should also be given to them to create tax-consciousness among the assesseees. The administration of sales tax should be centralised and the activities of the sales tax and income tax department co-ordinated.

TAXATION AND INFLATIONARY AND DEFLATIONARY SITUATIONS.

Question No. 40.—What are the scope and limitations of tax policy as an instrument for dealing with inflationary or deflationary situations in Indian conditions?

The economy of this country is not so organised as in the U. K. and elsewhere and in as much as the credit structure and foreign trade account only for a portion of the transactions that take place daily in the industrial and agricultural sectors, tax policy by itself cannot be very effective when dealing with the inflationary or deflationary situations. The aim must be to canalise business transactions through the credit structure as far as possible. Then only it will be feasible for Government to tackle the inflationary and deflationary situations through a combination of taxation measures, appropriate changes in credit policy and administration of physical and price controls.

Question No. 41.—In countering inflationary or deflationary conditions in the economy, what part would you assign to changes in the following:

- (a) direct taxes,
- (b) indirect taxes,
- (i) import duties, (ii) export duties, (iii) excise duties, (iv) sales tax?

Direct taxes have some effect only under very exceptional conditions. For instance, when the excess profit tax was levied during the World War II. Indirect taxes, have, however, a more important part to play in inflationary or deflationary conditions. Export duties can be levied with great effect to keep down internal prices as happened in the case of jute, cotton textiles, coal and others though one should be cautious in fixing the rates of duties. The import duties, excise duties and sales tax can be used for tackling deflationary conditions as these levies usually have a discouraging effect on consumption, though it has been complained at the present moment that these duties and taxes have actually had an inflationary effect because the increases have been overdue and have added to the cost of living.

Question No. 42.—To what extent is it possible to increase the inherent capacity of the tax system to counteract inflationary or deflationary conditions in the economy?

It is possible to increase the inherent capacity of the tax system to counteract inflationary or deflationary conditions in the economy, if it is completely organised and it is clear that judicious tax adjustments will have

the desired effect. Until the work in other directions has been achieved the tax system will not be able to increase its inherent capacity.

Question No. 43.—What are your views in regard to the relative importance of public expenditure policies in moderating the forces of inflation and deflation in Indian conditions?

The importance of public expenditure policies in moderating the forces of inflation and deflation in Indian conditions can be exaggerated. In fact, the objective of public expenditure policies in the present context should be such as to provide the necessary momentum to sustain a continuous increase in industrial and agricultural activity. It is just possible, however, that when there is worldwide inflation some care will have to be adopted in regulating public expenditure. Actually, fears were expressed to the effect sometime back that the large-scale expenditure under the Five Year Plan will have an inflationary effect and that ultimately the estimates will have to be revised upward. These apprehensions, however, have not proved to be correct as the inflationary forces, both external and internal, have been brought under check fully. Indeed, it has been considered necessary since the slump of March, 1952 to increase further outlay on the Five Year Plan.

Question No. 44.—Apart from using tax policy to counter inflation or deflation in the economy as a whole, would you suggest tax changes for dealing with the effects of rising or falling prices on particular groups of tax-payers or sectors of the economy?

Though it has been contended that the middle class income groups have been mainly responsible for accentuating inflationary forces there has been a considerable change in the basis of the economy in recent years. In our view, in the altered conditions, tax policy should be used for countering deflation or inflation in the economy as a whole.

Question No. 45.—How do you assess the present situation in regard to the strength of inflationary or deflationary influences, and what adjustments, if any, in taxation are indicated in the light of your views?

Inflationary forces have been actually brought under check completely in the past year or so and with a distinct increase in the supply situation there is actually need for lightening the burden of indirect taxation which bears heavily on particular industries. The authorities are aware of the regressive effect of export duties on many commodities and changes have been made. Nevertheless, it is found that even now hardships are still endured. It will now be more advantageous if the export duties are removed altogether except, perhaps, in some cases. The authorities may not be losers to any great extent as with an increase in turnover and profits income-tax proceeds will tend to be higher.

PART II.—DIRECT TAXES.

RESIDENCE.

Question No. 46.—Do the provisions of the Income-tax Act (Sections 4A and 4B) regarding the determination of residence of various assesseees, viz., individual, Hindu undivided family, firm, association, of persons and company, require any modification? In particular, what is your view regarding the retention of the category described as "not ordinarily resident"?

The Committee is of the view that even though Section 4A of the Act defines artificially the duration of residence and marginal cases may be seriously affected, the clear direction makes for precision and quick action. It has been recommended by the Income Tax Investigation Commission that Section 4B should be modified. There is no case for preferential treatment to a resident but not ordinarily resident to be assessed only on the basis of his Indian Income and not world income. Section 4B should, therefore, be abolished.

Income.

Question Nos. 47 & 48.—Does the definition of "income" [Section 2(6C)] require any modification? Are there any receipts of gains which are not taxed at present but which, in your opinion should be taxed and vice versa? In particular, what is your view regarding the taxing of capital gains?

The income of individuals, corporate bodies, insurance companies or others should be appropriately defined to exclude all capital gains, dividend incomes in the case of corporate bodies and capital surpluses arising out of valuation in the case of insurance companies, mutual or proprietary. The gains accruing to industrial undertakings through sale of worn out or obsolete plant and machinery should not be liable for taxation, even though limited to the amount of depreciation previously allowed. This has been the subject of considerable controversy in the U. K. and it is regarded that Section 10(2) (vii) of the Indian Income-tax Act causes undue hardship especially as the replacement costs at the present moment are very high. The profit on the sale of plant and machinery ought not to be subjected to tax, even to the extent referred to above, and it can be so enjoined,

if necessary, that the profits so made are specially earmarked for replacement purposes. Facilities should also be given to split the income of the husband and wife in order that the advantage of an averaging of the incomes may be available to the assessee. As the law obtains today the incomes of the husband and wife are assessed separately and there is no aggregation, except in cases where the wife has income from assets transferred to the wife by the husband. The aggregation in these cases is, however, to the disadvantages of the assessee and appropriate relief should be given. What we suggest, however, is this. Even where the wife or the husband has no income the facility should be given for submitting a joint return, at the option of the assessee, in the manner provided in the U. S. A. The greatest advantage of this procedure will lie in the assessment of incomes on the average basis. The split income facility was given in the U. S. A. in 1948. This permits the aggregation of the gross incomes of the husband and wife and dividing of such combined income in half after deducting their combined personal exemptions and credits for dependants. The tax is computed on one half of the net income and then multiplied by two. This privilege is available only when joint returns are filed. Even unmarried individuals, other than non-residents are allowed to take advantage of this privilege, if they maintain as a principal place of abode a household in which there resides one or more dependants, under certain conditions. A similar procedure might be adopted in this country.

Capital gains should not be taxed at all because the gains will be largely notional. Besides, fruitful employment of funds will be discouraged and investment activity will be penalised. Besides, the capital gain tax which in force for a short period, sought to penalise the group paying income-taxes and particularly gains made on the stock exchange even if it came about as a result of appreciation in the value of securities over a period. This tax certainly discouraged the incentive to invest. The appreciation in the value of securities comes about as a result of a combination of numerous causes. The average investor has to be encouraged to a certain extent as there is a normal expectation of appreciation in capital value over a period. The only limited application of taxing unearned increments can be in the case of inordinate appreciation in the value of property as a result of large-scale public expenditure or construction of public projects. With the levy of betterment fees, the benefit of which will be derived by the State Governments, the Union Government will not, however, be able to tax again these capital gains.

Question No. 49.—Have you any comments on the present position regarding taxation of profits, which accrue or arise abroad, on their repatriation to India?

The facilities given to Indian non-residents, who for the first time become resident in this country, to repatriate profits that have accrued abroad are not exactly calculated to be in the best interests of the country. At the present moment, facilities are given to the assessee, coming under the above categories, to repatriate accumulated profits within a stipulated period. It has also been enjoined that one half of the repatriated profits should be compulsorily invested in Government securities for a stipulated time. In order to encourage the repatriation of funds held abroad we suggest that there should be a longer time limit in such cases and that the compulsory limit for investment in Government securities should not also be so high. It is just likely that on repatriation, the profits are fruitfully employed or urgently required by the assessee concerned. The hardships in this regard should be minimised.

Question No. 50.—What change, if any, is called for in the definition of "dividend" Section 2(6A); e.g., in relation to "bonus shares"?

At present bonus shares, so long as they do not entail any release of any assets of the company, are not treated as "dividend" for tax purposes. But if the accumulated profits of companies are utilised for the purpose of starting subsidiary companies and the shares of subsidiaries are issued as bonus shares to the shareholders of the present companies such shares are treated as "dividend". The definition of income should be so modified as to exclude this "income" for tax purposes.

There is also need for modification of the present procedure adopted for the treatment of payments out of accumulated profits in a period of six years prior to liquidation. It has been stated that payments out of accumulated profits, if they have not been capitalized already and distributed as bonus prior to liquidation, should be treated as income. It is likely, however, that this procedure will act harshly if it has not been possible for the concern to wipe off early losses fully and technically there has been accumulation of profits in the eyes of the income-tax authorities. Since the shareholders are always entitled to a return of capital, at least to the extent subscribed for by them, it should be ensured that only such portion of the accumulated profits in excess of the paid-up capital should be attracted to tax.

It must also be agreed that dividend received by nominees on behalf of the real owners should be allow-

ed to be returned as income by the real owner for tax and rebate purposes.

Question No. 51.—Do the provisions of the Income-tax Act relating to the taxability of non-residents through their business connections in India in respect of incomes deemed to accrue or arise within the taxable territories (Sections 42 and 43 of the Income-tax Act) affect adversely the interests of persons engaged in foreign trade? If so, what modification would you suggest in these sections?

There have been many controversial decisions in regard to the determination of liability of profits arising out of business transactions with non-residents.

Question No. 52.—What modification would you suggest in the definition of "agricultural income" Section 2(1) to avoid the contingency of the same income being taxed by the Central Government as well as the State Governments, e.g., in respect of income from forests, dividends from agricultural companies, etc.?

The definition of "agricultural income" as at present conceived has certain anomalies in that in the case of the tea industry a portion is allowed as agricultural income while the balance is charged as business profits for tax purposes by the Centre. Besides, the dividends derived manifestly from agricultural income, specially in the case of tea estates, are not treated as "agricultural income" and the procedure adopted for rebate purposes has given rise to much controversy. Such portion of the income which is treated as agricultural income for tax purposes at the hands of the company should also be allowed in the case of the recipients of tea dividends. Dividends received from purely agricultural companies also should not be included for tax purposes.

The greatest hardship, however, is now endured by Indian citizens possessing agricultural property in India and Pakistan. Since income derived from agricultural lands situated in a foreign State is treated as non-agricultural income for tax purposes by the Central Government and the tax is payable under Section 10 as income from business profession or vocation, there is double taxation which has had a crippling effect. There should, therefore, be some definite understanding between India and Pakistan in this regard.

Question No. 53.—Are you in favour of integrating agricultural income with non-agricultural income for rate purposes? If so, which of the following methods would you advocate:

- (i) Aggregation of agricultural and non-agricultural incomes only under the State Acts;
- (ii) Aggregation of agricultural and non-agricultural incomes only under the Central Act;
- (iii) Aggregation of agricultural and non-agricultural incomes both under the State and the Central Acts?

We are not in favour of integrating agricultural and non-agricultural incomes for this purpose though it will be necessary to ensure that the revenue through taxation of agricultural incomes is increased. The agricultural income-tax is not levied uniformly. Neither is the tax imposed by all the States. It is desirable to have centralised direction and defined policies. The benefits accruing as a result of the taxing of agricultural incomes should continue to be available to the State Governments completely as there is already a feeling that the Centre has kept for itself the more fruitful sources of revenue and any attempt towards further centralisation for the benefit of the Centre will be resisted.

Question No. 54.—Would you recommend the abolition, by a suitable amendment of the Constitution, of the distinction between agricultural and non-agricultural incomes and the taxation of both types of income, aggregately under a Central Act?

Having regard to the answer to Question 53 the amendment to the Constitution empowering the Central Government to levy taxes on agricultural income is not necessary.

Question No. 55.—Is the treatment given to irregular and fluctuating income in the present law satisfactory? In particular, should any changes be introduced—

- (i) to average income over a number of years where receipts are irregular and fluctuating;
- (ii) to spread lump sum receipts over a number of years?

The treatment given to irregular and fluctuating incomes in the present law is not satisfactory.

In respect of artists, authors and others there are at present facilities to average incomes over two or three years as the case may be. But the average income over-assessed has proved to be higher than actual experience and we feel that a longer period, say five years, should be allowed for averaging the income. Also, in view of the peculiar nature of the work, a greater portion of the income should be made eligible for earned income exemption. The same treatment should be accorded to profits arising out of contracts and dividends

for periods longer than a year declared in one year as in the case of cumulative preference shares.

Question No. 56.—Do you think the present provisions regarding exemption of charitable and religious trusts need any modification? If so, in what respects?

The principal criterion should be to ensure that the income of charitable and religious trusts is utilised for charitable purposes for the benefits of Indian nationals both in India and abroad. Business profits of trusts should be exempted from tax while expenditure incurred on education of Indian nationals in foreign countries should be allowed for tax purposes. The present facilities given to private trusts should continue to be available.

Question No. 57.—(i) Should the business profits of co-operative enterprises, which are not exempt, be charged to income-tax and super-tax? If so, should co-operative societies be treated as companies or should a lighter levy be imposed? In case the exemption is continued, should it be restricted to certain categories of co-operative enterprises?

(ii) Do you agree with the view that the income derived by co-operative housing societies by way of rent should not be treated as income from property assessable to income-tax? Would you, in this respect, differentiate between tenant co-partnership housing societies and other types of housing societies?

(iii) It has been suggested that there are divergent decisions by different Income-tax authorities in respect of assessment of income of co-operative societies from sources other than business. If this is so, please indicate such decisions and the measures you would suggest to secure uniformity in assessment.

(i) The business profits of co-operative enterprises should normally be charged to income-tax and super-tax as they rank in the same category as trading concerns. It will, however, be necessary to continue to exempt credit co-operative societies.

(ii) The income derived by co-operative housing societies cannot be treated fully as income from property assessable to income-tax as there is a capital element in the rents received especially in the case of tenant co-partnership housing societies. In the U. K. house building societies have been very successful as the taxation policy has been properly conceived. It is very necessary in the present conditions for the promotion of building activities which will help generate employment.

Question No. 58.—Are you in favour of continuing the concessions given to new industrial undertakings under Section 15C of the Income-tax Act? Have initial and extra depreciation allowances made the concessions practically infructuous? If so, what are the directions in which the provisions of this section should be modified?

The concessions given to new industrial undertakings under Section 15C of the Income-tax Act exempting profits for five years ending March, 1954 up to 6 per cent. per annum on the capital employed have not in fact been fully operative as in many cases the initial and special depreciation allowances have been so large that the profits have not been taxable. There is, however, a fundamental difference between the relief obtained as a result of the concessions under Section 15C and the relief obtained as a result of the larger provision out of profits towards initial and extra depreciation allowances. In the former case, there is a real advantage while in the latter there is only deferred tax payment. In order to help those industrial undertakings which have incurred large expenditure on buildings, plant and machinery it must be so arranged that the profits are assessed for tax purposes in the manner as if no initial depreciation allowances are permissible and the additional sums towards depreciation which interfere with concession, should be allowed to be used towards reduction of taxable profits when the occasion for paying taxes arises. If some arrangement like the above were not devised the objective of giving encouragement to new industrial undertakings will not be satisfied. Also, we feel that companies embarking on expansion plans should be allowed similar concessions in respect of that capital which is employed for expansion purposes. Again, Section 15C (ii) is restrictive in effect and it should be so arranged that companies are enabled to take advantage of the benefit for five years from the date of commencement of production. The amendment act no doubt has extended the facility so that it can be available for concerns which come into production before 1954. This restriction should be removed.

Question No. 59.—A suggestion has been made that banking profits of foreign branches of Indian banks should be given concessional treatment for tax purposes in order to encourage the opening of branches abroad. What are your views?

In order to build up invisible exports and help finance a larger part of our foreign trade through the establishment of branches of India in foreign countries, concessional treatment for tax purposes should be given.

This is very necessary because Indian banks have to reckon with serious competition from established foreign banking institutions and the cost of establishing and running branches in foreign countries is prohibitive. Profits for a period of ten years might be exempt from taxation especially as they will be subject to taxation in the foreign countries.

Question No. 60.—Should any liberalisation be made in the present limits of exemption from tax of life insurance premia and contributions to provident funds?

It has been persistently pointed out that the present limits of exemption from tax of life insurance premia should be increased from one-sixth of the annual income allowed presently to one-fourth of the annual income and that the maximum amount also should be increased from Rs. 6,000 to at least Rs. 10,000. This will help capital formation in the private sector considerably and encourage thrift. Besides, contributions to provident funds should be allowed as deductions separately.

Question No. 61.—(i) Do you favour the grant of larger depreciation allowances to assist industry to finance the considerably increased costs of replacement of assets? If so, how and in what form should they be given—

- (a) by larger depreciation allowances on new assets;
- (b) by revaluation of existing assets;
- (c) by treating the excess of replacement cost over original cost as revenue expenditure;
- (d) by any other method?

We have already discussed the question of depreciation allowances and replacement costs, in a study published by the Association, copy sent herewith. The conditions in this country are peculiar and it has so happened that on account of the intervention of World War II and the heavy wear and tear due to intensified working over several years, in connection with the war effort, it has become necessary to replace plant and machinery. The process of rehabilitation bids fair to occupy several years. Even with a conservative policy in regard to the payment of dividends and regular allocation to reserves it has not been possible to find the requisite resources to retain intact physical capital. The experience of individual industries has not been uniform and in spite of the best efforts considerable arrears of replacement have to be made good. It will not, therefore, be possible for the private industrial sector to carry out the programme unaided. The existing depreciation allowances enable only a larger write off in the earlier years, after the new plant and machinery have been installed. As there is a ways and means problem and many industrial units have not been able to think even in terms of large-scale replacement of worn-out plant and machinery, owing to the paucity of existing resources, additional depreciation allowances on a tax free basis may be granted in respect of plant and machinery will represent some technical progress and the higher price might be offset to a certain extent by increased efficiency and in view also of the fact that the Exchequer may not be able to bear the excess cost of replacement fully in the shape of depreciation allowances. We suggest that half the net differential cost should be granted in the form of additional tax-free depreciation allowance. The necessary sums made available in this manner could be credited to a fund to be drawn upon by the units concerned at the time of actual replacement.

Question No. 61 (ii).—What is the justification for assistance from public resources to certain classes of taxpayers only by way of covering partially the excess of replacement cost over original cost of old assets?

The private industrial sector in this country can claim assistance from public resources as it suffered greatly in the inter-war period due to the unhelpful policies of the then existing Government and during the war years there was kill-to-death working of available machinery. The profits earned did not provide adequately for wastage of capital while due to the dependence on outside sources of supply and the non-availability of capital goods for quite a long time, after the termination of hostilities, available resources have been found inadequate and replacement costs have risen high. All the established industries have to renew their plant and machinery simultaneously and in the next few years a good part of the rehabilitation programme will have to be completed. It is very essential in the interest of the general economy to revitalise the industrial sector and enable it to retain its physical capital intact.

Question No. 61.—(iii) In case adequate justification exists for assistance by Government in the form of tax concessions to meet the situation, what safeguards should be prescribed to see that the funds so made available are utilised for the purposes for which they are introduced?

It is not as if the various managements have been sitting idle and have not made serious efforts to push through the rehabilitation of various industrial units,

as far as possible. In fact, as has been pointed out by us in our study entitled "Depreciation Allowances and Replacement Costs", the various industries have utilised available resources for meeting the increased requirements for replacing plants and of working capital. The difficulties have been so serious that it has been necessary to utilise fully profits ploughed back as well as free resources and also raise additional capital in various forms and increase current debts in the bargain. With the result, in the absence of adequate capital formation within the corporate sector and liberal depreciation allowances for replacement of over-aged plant and machinery, it has become difficult for the same rate of progress to be maintained and the expectation in the coming years will not materialise.

Having justified the need for the grant of additional depreciation allowances on a tax-free basis and lower tax on undistributed profits, the Government might probably enjoin that such of the funds as are not immediately put to use for replacement purposes and which accrue to the credit of the companies concerned out of special concessions, should be deposited in a special fund created for the purpose such that the unused resources are available for meeting the requirements of others in needs. This special ear-marking of resources released by Government will help the rehabilitation programme to a great extent. Under our scheme, such of those units as have to replace plant and machinery after a period of years and are in a position to earn special depreciation allowances could make available these sums for use by others. If pooling was done on this basis and the benefits of concessions are made available only when capital expenditure is incurred on the replacement programme it would be possible to ensure that the funds are utilised for the purposes for which they are intended.

Question No. 62.—Are any changes called for in the classification of assets for purposes of depreciation, rates of depreciation and methods of computing the allowances?

There should be a more scientific classification of assets for purposes of depreciation. At present difficulty is encountered in respect of buildings which have been renovated or extended. Besides, moving parts having a greater rate of depreciation have not been classified as such. As regards the rates of depreciation and methods of computing the allowances, greater latitude should be given for writing off of obsolescence. In fact, the accelerated depreciation method, as adopted in the United States and elsewhere, should be followed while in respect of old plant and machinery we have already suggested that greater depreciation should be allowed in order that increased costs of replacement do not cause any great difficulty. In regard to normal depreciation allowances, there should be a reversion to the procedure adopted prior to 1948-49. At the present moment, depreciation charges are allowed only on the basis of the actual number of days worked. This naturally involves considerable work in the department as well as on the part of the assessee. Besides, it may not be possible for plant and machinery to work continuously over a period due to unforeseen circumstances. It is also necessary to remember that depreciation is greater when plant and machinery are idle.

Question No. 63.—Should any tax concessions be given to encourage development of mineral resources? If so, what form should they take? In particular, should depletion allowances on wasting assets be allowed? How should it be computed for different kinds of assets you have in view?

Tax concessions should be given to encourage the development of mineral resources. It has been represented for a long time to the authorities in this country that special consideration has not been given to the peculiar nature of the business of mining as the profits earned are dependent on the life of the reserves and there is a capital element involved in determining profits in the real sense of the term. So far as mining concerns are concerned it is thus necessary to devise depreciation allowances on a different basis. In the advanced countries of the West such as Canada, U. S. A., etc., depletion allowances are permitted. The reserves of minerals are exhausted over a period and the life of a company operating such resources is dependent on the life of the reserves of minerals exploited and the rate of extraction, different from manufacturing of goods or other items. It is necessary, therefore, to calculate depletion allowances in such a way that the loss of capital on account of wastage of assets is recovered over a period.

The nature of depletion allowances will, of course, vary with different kinds of assets and the different character of the resources. In the case of iron ore this allowance need not be very liberal as the resources are inexhaustible and it may not be possible for any single mineowner to work out property in a short period of years. In the case of coal, manganese ore, gold and others there is, however, need for a different policy.

In the U. S. A. provision is made for depletion in the case of coal mines at 5 per cent., metal mines, fluorspar, china clay, flake graphite, ball saggor and rock asphalt

mines at 15 per cent. and sulphur mines or deposits at 23 per cent., on the gross income from the property during the taxable year.

In addition to the above allowances percentage depletion at the rate of 15 per cent. of gross income from the property is allowed on bauxite, vermiculite, beryl, feldspar, mica and tale (including pyrophyllite), barite, lepidolite, spodumene, phosphate of rock, throna, Lentonite, gilsonite, thenardite (from brines or mixtures of brine) and potash mines or deposits.

As in the case of oil and gas wells, there is excluded from the gross income of the taxable year as a basis for this percentage of depletion deduction of an amount equal to any rents or royalties paid or incurred in such year by the taxpayer in respect of the property, and in no event can this percentage-of-income depletion allowances exceed 50 per cent. of the net income from the property.

Question No. 64.—In what form would you provide for personal and family allowances—

- (i) exempting the first slice of income from tax; or
- (ii) providing specific allowances for family and dependants?

In the case of (i), do you consider that the first slice—Rs. 1-1,500 you give to the Hindu Undivided family?

As in the advanced countries of the West, provision should be made in the Indian income-tax regulations for granting larger family allowances. At present only the earned income relief and life insurance premium relief are afforded. It is imperative that children's allowances and dependent relatives' allowances on the model of the advanced countries should be granted. The procedure suggested is, that, after arriving at the total income of the individual assessee, deductions should be allowed depending on the size of the family on a percentage basis. A reasonable amount of the medical expenses incurred by the family (subject to a certain maximum) should also be allowed to be deducted from the total income. Reasonable allowances should also be given for expenses incurred in connection with education and travel (of a special type). The tax on this net income should be calculated on the basis of a unified rate structure. If this method is adopted it will not be necessary to have a slice like 0-1,500 which should be tax free. In the United Kingdom the total number of assesseees in the income-tax bracket is 20 million. But after the grant of various allowances only 15 million pay income-tax.

Question No. 65.—Should the present law regarding admissible expenses Section 10 (2) be altered. If so, please indicate with reasons, the items of expenses (i) which are not now admissible but, in your view, should be admissible and (ii) which are now admissible but, in your views should not be admissible?

With the new responsibilities on business and industry to provide amenities to staff and with the large expenditure incurred in respect of tax returns, employment of technical experts, selling of wares, etc., the Income Tax Department should adopt a reasonable attitude and allow particular items of capital expenditure which are not exactly productive or revenue expenditure which has an element of capital expenditure to be debited to the revenue account. No difficulty should be encountered in respect of expenses incurred for business purpose, education, etc. In regard to payment of bonus to staff, there is a disposition on the part of the authorities to question such payments if they happen to be excess of 2 or 3 months' salaries or wages. Where bonuses have been actually paid even if they exceed 2 or 3 months' salaries or wages and are considered "excessive" by the authorities, they should be allowed for as expenses for tax purposes. No difficulty should be experienced in this regard.

RATE STRUCTURE—

Question No. 66.—(a) Are you in favour of combining income-tax and super-tax into a consolidated levy? (b) What are the merits or demerits of such a step from the point of view of (i) assesseees, (ii) administration? (c) Are you satisfied with the degree of progression in the present rate structure (both income-tax and super-tax) specially in regard to its economic effects? (d) In case you consider a change is necessary, what alternative rate structure would you recommend? (e) Should the rate of surcharge levied under Article 271 of the Constitution also be graduated?

We are in favour of combining the income-tax and super-tax into a consolidated levy so far as personal incomes are concerned. There is no special merit involved in the present procedure except that, for income-tax purposes, earned income allowances are given. Besides, the rates of super-tax are so steep especially in the higher ranges that the incentive to earn has been seriously discouraged. The rate structure should thus allow for gradual progression and not more than nine annas in the rupee should be charged on the highest income

slabs. This maximum rate should be reached at a level not less than Rs. 2½ lakhs.

We have already indicated in Part I that the income and super taxes levied in India are among the highest in the world, indeed next only to the U. K. An analysis of the rates levied in the U. S. A. and Canada, however, shows that the maximum rate of 88 per cent. is attracted in the U. S. A. on incomes above Rs. 20 lakhs on the split income basis. In Canada, the maximum rate of 80 per cent. is paid only on incomes over Rs. 20 lakhs (1950-51). The economies of these countries, it should be remembered, are highly advanced and unless incentives are given in the case of assessee in a country like India, which is rather backward relatively, the necessary progress cannot be attained.

As far as possible the practise of levying surcharges should be discontinued as it has always happened that surcharges levied over a period have been ultimately consolidated into basic rates.

In regard to corporate taxation, the burden in Australia is very much less. In the latter country, only 6sh. in the Pound on the first £5,000 and 7sh. in the Pound on the balance is levied in the case of public limited companies. In the case of private limited companies, 4sh. in the Pound is levied up to £5,000 and 6sh. on the balance. Actually, in Japan there is no income-tax in respect of corporate profits as it is regarded as sufficient "to impose the income-tax upon the stock holders, etc., as the income-taxation", when the corporate income is distributed among the stock-holders. In computing the income-tax of an individual, however, "such amount paid or the corporation tax is credited against the income-tax and only deficiency, if any, is collected as income-tax. In India, apart from the fact that depreciation allowances on the basis of original cost result almost in taxation of capital, the burden of corporate taxes is as much as 45 per cent. even allowing for the rebate in respect of undistributed profits against less than 35 per cent. in the case of public limited companies and less than 30 per cent. in respect of private limited companies in Australia.

Question No. 67.—*Have you any change to suggest in the exemption limit for individuals (Rs. 4,200) and for Hindu undivided families (Rs. 8,400)?*

It is not really necessary to raise the exemption limits if the allowances asked for in answer to Question 64 are given.

Differentiation.

Question No. 68.—*(a) Are you in favour of a distinction being made between earned and unearned incomes? What is the economic justification for such a distinction? (b) Is the present definition of "earned income" in Section 2 (6AA) of the Income-tax Act adequate in this respect or would you suggest any modification? (c) Should the quantum of relief now afforded be extended or reduced? If so, to what extent?*

We are in favour of continuing the distinction between earned and unearned income. It is very necessary to distinguish between the two types of incomes as then only it will be possible to give greater encouragement to individuals who seek to increase the wealth of the country through their personal efforts.

The definition of "earned income" in Section 2 (6AA) of the Income-tax Act is satisfactory enough but it would be necessary to allow uniformly a fixed percentage of the earned income for exemption purposes as, otherwise, greater effort would be discouraged. At present 20 per cent. of the earned income up to Rs. 20,000 is eligible for earned income exemption and above this level only Rs. 4,000 is allowed. Having regard to the fact that the middle income groups have grown in importance and the increased salaries have no great significance, under inflationary conditions, it is necessary to make available this concession on a percentage basis, for all those who are in receipt of earned income.

Question No. 69.—*Have you any change to suggest regarding the principles followed in valuing stocks of a business for assessment purposes?*

The usual method of valuing stocks and stores at the end of the accounting period is to take the lesser of the actual cost or the market price. Average prices over the period are also taken and these are permissible by the Department if this had been the consistent practice. It is also permissible to value a portion of the stock at the lower of the market or cost price and the others by the average price method. (*Vide C. I. T. vs. Chari & Ram, 1949, I. T. R. I.*) We feel that the present procedure should continue. It is necessary, however, to make a provision for writing off exceptional losses on account of the decline in the value of stocks as happened early in 1952 after the accounts have been closed in many cases. While liberal facilities for the payment of taxes might be helpful, unexpected developments have actually resulted in wiping off the profits which were computed on a particular basis. In these cases there should be a revision of assessments.

Miscellaneous.

Question No. 70.—*Do you consider that any change is called for in the method of assessment of the Hindu undivided family? If so, in what respect?*

The facility for individual assessment should be given to the various major members of a joint-family as in the event of a large number of claimants the incidence of taxation, even with the doubling of the exemption limit as at present, has tended to be heavy. It should be so arranged that the individual members are treated as if they are eligible for exemption limits on the normal basis.

Question No. 71.—*Should exemption from income-tax be allowed in respect of voluntary surrender by managing agents of the whole or a part of managing agency commission? What safeguards should be laid down against misuse of such a provision?*

Exemption from income-tax should be allowed in respect of voluntary surrender by managing agents of the whole or a part of managing agency commission, as the managing agents have helped to a great extent businesses in difficulty and the commission due had to be waived if the profits were low or heavy losses had been incurred. Also, in some cases commission has been forgone for application to philanthropic or charitable purposes. In such cases, there should not be any difficulty in obtaining exemption and it should not be made conditional that the managing agents should declare their intention in advance. Reasonable safeguards can be adopted. But the intention behind the act of the managing agents should be the guide.

Question No. 72.—*On what basis would you suggest that double income-tax avoidance agreements should be concluded between India and other countries?*

Double income-tax avoidance agreements should be concluded between India and other countries only in such cases where there is definite advantage accruing to us or it is possible to attract foreign capital. It is necessary to have clear-cut arrangements in regard to taxation of profits from businesses or individuals in order to promote trade and industry.

Question No. 73.—*Is the present law relating to determination of "Bona fide annual value" of property and deductions allowed from it satisfactory? If not, please give any alternative proposals you have in this respect.*

The bona fide annual value should not be artificially determined and the owner should not be obliged to pay tax on incomes which are not in accordance with realities and here there has been no attempt to suppress income. In fact, the owner should be enabled to have refunds of tax when rents are in arrears and could not be recovered. The deductions allowed are not such as to encourage constructional activity. It is necessary to permit regular depreciation allowances on private buildings as well.

Question No. 74.—*Is any change required in respect of provisions relating to carry forward of losses? Are you in favour of allowing losses to be carried backward in case of cessation of business?*

There should be provision for the carry forward of losses without any limit as it has happened to many business to sustain losses over a long period in the formative stage or due to unforeseen circumstances. Even though it would mean loss of revenue immediately to the Exchequer the facilities to carry back losses should be given to peculiar cases where it is not possible to pay taxes immediately and there was no possibility of returning to the profit earning stage in a reasonable time. It may, however, be considered necessary to run the businesses for other considerations. Some facility in this respect is available in Japan. In the event of cessation of business, losses should be allowed to be carried back for at least three years. There should also be provision for set off of losses carried forward against various businesses.

Question No. 75.—*Do the provisions relating to the payment of advance-tax under Section 18A of the Income-tax Act need any modification?*

In a period of high profits or stable profits the pay-as-you-earn scheme was very helpful to the Exchequer and the assessee also did not experience any great difficulty in meeting the demands of government. But with the change from a sellers to a buyers market the demands on the basis of the previous year's assessment have caused great hardship. Besides, considerable difficulty has been experienced in getting refunds when the advancement payments proved to be in excess of the taxes due. Section 18A should not, therefore, be operative in the present conditions.

Question No. 76.—*Do the principles underlying the assessment under Section 34 of the Income-tax Act need any modification?*

The powers under Section 34 are so sweeping that it has very often led to arbitrary assessment and unnecessary harassment. In a country where the average assessee is not well informed, the penal element in

assessment under Section 34 should not be heavy and reopening of assessments over a period of 4 years should not be adopted. There should be a finality about assessment completed and which relate to a period earlier than four years. It has so happened that the assessee concerned have not been regularly submitting returns or making separate returns and there is no deliberate intention to evade taxes. In the absence of regular accounts summary assessments have had a penal effect. Actual penalties have added to the crushing burden.

It would be helpful from the point of view of assesses if the Income-tax Department could ask for specific information on particular points and give them to understand what information they have in their possession. If there has been unintentional escapement no harassment should be caused, and penalty should not be levied except where there is wilful evasion.

Question No. 77.—What measures would you suggest for simplifying the procedure of assessment in order to reduce the cost of compliance with tax regulations?

Greater reliance should be placed on the reports of Auditors and their statements should be accepted. Departmental delays also should be avoided as far as possible and Section 23(B) should be deleted as provisional as well as actual assessments cause unnecessary hardship. So long as Section 18A is in force there should be immediate refunds of excess tax paid to avoid needless hardship to the assessee.

Question No. 78.—It has been suggested that the Appellate Tribunal should have powers to enhance assessments in the same manner as Appellate Assistant Commissioners have. What is your opinion?

At present only the Appellate Assistant Commissioners have got powers to enhance assessments. The Appellate Tribunal can only make an observation and it is for the Income-tax officers to act. There is, therefore, no case for worsening the position of the assessee.

Taxation of Companies and Shareholders.

Question No. 79.—Do you recommend that an element of progression should be introduced in the corporation tax?

Except in regard to the distinction between small and large businesses, the element of progression in the corporation tax has not been adopted in any of the important countries in the world. Besides, since corporate activity is based on the co-operative effort of a large number of individuals belonging to the community it would be invidious to accept the principle of progression. We have actually suggested that the income-tax and corporation tax should be combined. The total rate also should be fixed lower.

Question No. 80.—Would you advocate different rates for different types of corporate enterprises, e.g.—

- (i) small industries;
- (ii) cottage industries;
- (iii) private limited companies or what may be termed proprietary companies;
- (iv) hawkins companies?

Except for the difference in tax rates as applicable to small and big corporate bodies the tax machinery cannot be of much help in developing small scale and cottage industries. Other methods have to be adopted. It may be stated that the corporation tax, when levied, should not be applicable to companies earning profits below Rs. 25,000.

Question No. 81.—There is a demand for the exemption of inter-corporate dividends from corporation tax. Do you consider this justified and, if so, why?

The demand for the exemption of inter-corporate dividends from corporation tax is completely justified as we have already put forward the suggestion that the concession that is now in operation regarding the receipt of dividends from new industrial undertakings which have come into existence after March 31, 1952 should be extended to all. It will then be possible to utilise available funds for productive purposes. It will be recognised that there is no case for taxation of the same income twice and the corporation tax paid at source should also be eligible for tax credit. This suggestion is inherent in our proposal for a consolidated levy on corporate profits.

Question No. 82.—Do you think that any special provisions are necessary for the assessment of—

- (a) banks; and
- (b) investment companies?

Do existing rules relating to assessment of insurance companies, especially mutual insurance associations, require any change? If so, in what respect?

Banks and Investment Companies are in receipt of dividend and interest on securities on a substantial scale and it has been represented that this portion which goes to make up profits should not be liable for corporation tax. This suggestion will be met in part if our claim for including corporation tax for rebate purposes is conceded. It is necessary to strengthen the credit structure

and encourage the promotion of investment trusts by according special concessions.

As regards insurance companies the controversies relating to taxation of entire valuation surpluses should be considered and it should be ensured that no part of the surplus which has arisen out of the payment of loaded premiums is taxed. The Income-tax Amendment Act has exempted from tax 80 per cent. of the amounts reserved for or expended on behalf of policy holder. But since Government have regimented the insurance industry the entire amount reserved for or expended on behalf of policy holders should be exempted completely. In any case, mutual companies should be accorded favourable treatment. Besides, insurance companies transacting life business must be taxed at a lower rate than now.

Question No. 83.—Do you think that differentiation should be made between distributed and undistributed profits of companies for tax purposes? If so, on what grounds? What change would you suggest in the present quantum of differentiation in favour of undistributed profits? Should the concession in future be restricted to particular industries?

If the tax concession in favour of undistributed profits is allowed to continue as at present or in a modified form, what measures would you suggest to ensure—

- (a) that retained profits are not used as a device by shareholders of private limited companies to evade super-tax;
- (b) that retained profits are actually applied for productive purposes?

In particular, are the provisions of Section 23A of the Income-tax Act satisfactory? If not, what changes would you suggest?

In order to promote capital formation in the corporate sector it has been repeatedly emphasised by our Committee that there should be differentiation between distributed and undistributed profits of companies for tax purposes and that undistributed profits should not be taxed at all. At present, a rebate of only 1 anna per rupee is allowed in respect of undistributed profits. It is very necessary to encourage the ploughing back of profits as far as possible as the established industries particularly are not able to find the necessary funds for replacing worn-out plant and machinery and on account of the inflationary rise in prices, the requirements of working capital also have increased considerably. Any concession in the matter of exemption of undistributed profits should be extended to all the industries. It will, however, be desirable to have a simplified tax levy which will produce the desired results.

In regard to Section 23A the compulsion to distribute 60 per cent. of profits or 100 per cent. where reserves equal the capital is acting as a great handicap. This section should be completely deleted and it should also be agreed that profits distributed by private limited companies, in which there is proprietary element, should be treated as earned incomes. Besides, for the duration Section 23A is in force as there should be facility for prior consultation with the Income-tax Officer and where a dividend has been distributed in prior consultation no penalty should be leviable if the profits are found to be larger later. It may be difficult to compel immediate utilisation of retained profits though the actual trend is towards complete absorption of available funds for productive purposes and there has actually been an increase in current debts after utilising all available debts. It may, however, be directed that, over a period of years, the profits are applied for productive purposes.

Question No. 84.—Do you think, in view of the fact that profits distributed by a company are subjected to corporation tax, it is appropriate that they should also be charged to super-tax in the hands of shareholders? If not, what are your suggestions in this regard?

Tax free dividends can be subjected to super-tax in the hands of shareholders if the Government agree to make eligible for rebate purposes super-tax paid by companies in respect of dividend income returned by individual assesses for tax purposes. We have, however, been urging that corporation tax paid by companies should also be eligible for rebate purposes for all as it will encourage investment activity. Besides, when it is recommended that income-tax and super-tax should be unified, credit should be granted for the entire tax paid to all dividend recipients.

Question No. 85.—Would you consider that industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies should be required to contribute, from their earnings in the way of income-tax or in other ways, to general revenues?

Industrial, commercial and similar other enterprises undertaken by the Centre, the States and Local Bodies should be required to contribute from their earnings by way of income-tax or in other ways just as the private sector is obliged to do. Only in that event it will be possible for Government to know that activities in the public sector are carried on correctly.

Evasion and Avoidance of Tax.

Question No. 86.—What measures would you suggest for the greater use of the services of Chartered Accountants for assisting in the determination of the taxable income of assessees? What obligations should be placed on a Chartered Accountant, when he certifies a statement of accounts of an assessee for purposes of income-tax assessment? In particular, with a view to minimising evasion of tax, would you recommend that the certificate of Chartered Accountant should invariably accompany the return for business income over a certain limit? If so, would you suggest that a form of certificate should be prescribed indicating the scope of the check that should be exercised by Chartered Accountants who render the certificate mentioned above? Do you agree that fees payable by assessees to Chartered Accountants for such certificates should be restricted to a schedule to be prescribed by Government?

The Committee have already indicated in the reply to Question No. 77 that the certificates of Auditors can be accepted for expediting assessments. The Chartered Accountants should for their part discharge their functions properly and if need be a regular form of certificate can be prescribed. The department, however, should not make it obligatory for the assessees to secure their certificates. The form of the certificate should be drawn up by the Institute of Chartered Accountant in consultation with the Central Board of Revenue. It should be made optional in order to expedite assessments.

Question No. 87.—What changes would you suggest in the present law relating to the representation of assessees before Income-tax authorities (Section 61) in order to ensure—

- (i) effective representation of assessees at reasonable fees;
- (ii) a minimum level of proficiency on the part of representatives regarding the subject of income-tax law, rules and regulations?

We do not feel that there should be any major change in the existing law. It will, however, be helpful if in the case of new assessees or illiterate assessees the Income-tax Department can provide the necessary help and thus bring about equitable assessment and develop closer relations with the tax paying public. There should actually be Departmental Officers appointed for the purpose. A beginning has been made with Public Relations Officers. But those cannot discharge the functions which we expect.

Question No. 88.—Will it assist in checking evasion if the names of the persons who are penalised for concealment of income are published?

In view of the fact that there have been genuine cases of difference regarding the nature of income returned or whether such income is eligible for tax purposes or not it will not be correct to publish the names of persons who are 'penalised' for concealment of income. Besides, it will be against the existing practice which we consider correct.

Question No. 89.—Do you think that the present practice of excluding, from taxable profits, perquisites given to employees of business undertakings results in considerable loss of revenue? If so, please state the perquisites you have in mind, and how they should be dealt with for the purpose of taxation.

There is not much benefit derived by employees of business undertakings in the perquisites given to them. No changes are, therefore, required.

Question No. 90.—In the case of a company under liquidation, what steps, if any, would you suggest for safeguarding payment of tax dues before any payments are made to shareholders?

We do not believe that the Government will be entitled to any special treatment to safeguard payment of outstanding dues. Outstanding tax payments should rank in the same fashion as other liabilities.

Question No. 91.—Do you think that, in order to minimise evasion and avoidance of tax, there is a case for conferring larger powers on income-tax authorities? If so, what further powers should be given to them? In particular, should powers to search premises and seize documents and books of accounts be given to Income-tax authorities? If so, what is the lowest grade of officer on whom you would confer these powers?

Tax evasion is not anything peculiar to this country and it has always happened due to the inefficiency of the departments or the lack of the suitable personnel. Even with better administration and greater co-operation between the authorities and the assessees much of the tax evasion can be prevented. Drastic powers to search premises and seize documents and books of accounts should not be given to the Department.

Question No. 92.—What precautions are necessary and possible to prevent the creation of an artificial legal entity—a trust or a private limited company or a

partnership, especially family partnership—either for avoiding payment of income-tax or for fractioning of income to escape higher rates? Would you recommend the use of penalty rates of tax to minimise such practices?

It would be hard to distinguish between genuine and artificial cases and it has so happened in the past decade and a half that corporate activity has been helpful in furthering development of industry and trade. Within the framework of law, it is always open to the assessee to adjust his affairs in a manner which attracts the minimum tax liability. It would be worthwhile to undertake an enquiry into the working of the various firms of business organisations and find out whether the interests of Government have suffered. No penal rates of tax should, in any event, be imposed. Everything is dependent on prompt and fair assessment.

Recovery.

Question No. 93.—In the case of a registered firm, would you advocate recovery of unrealised tax of any partner from the firm as such or from the other partners?

Recovery of unrealised tax of the partner cannot be affected from the firm as such or from other partners, as the drawing would have already been made in respect of a particular accounting period though it may be directed that, in the event of the continuance of the interests of a partner in the partnership concerned, the future share of profits might be earmarked for the payment of tax dues. The firm or other partners should be informed accordingly. The liability is always to be borne by the partner concerned.

Question No. 94.—Are present arrangements relating to recovery of income-tax adequate? Would you advocate the Income-tax Department having a separate machinery for enforcing the recovery of arrears of tax?

The present arrangements relating to the recovery of income-tax are rather sufficient. It would nevertheless be advantageous to have a separate machinery for enforcing the recovery of arrears of tax within the Department itself as there is at present lack of co-ordination between the Income-tax Department and the Certificate authorities and unnecessary harassment is caused to the assessee. If the machinery were in existence there would probably be scope for better understanding of the difficulties of the individual or corporate assessees and the necessary arrangements can be made through mutual co-operation.

Question No. 95.—What provisions should be made to ensure timely collection of tax from private limited companies? Do you consider that liability for payment of tax in such cases should be placed upon shareholders of the company in proportion to their shareholdings?

Timely collections of tax from private limited companies can be made only through timely assessment. There is no case for fixing the liability for arrears of tax on the shareholders even if it be in proportion to their shareholdings, as in that event there would be no meaning to the principle of limited liability.

Question No. 96.—If income from any property is included for assessment purposes in the hands of a person other than the ostensible owner, would you agree to the tax so assessed being also made recoverable from such property?

Any attempt to recover tax assessed on income from property included for tax purposes in the hands of a person other than the ostensible owner to be recoverable from such property which will create legal complications.

General.

Question No. 97.—What concrete measures should be taken to improve the relations of the Income-tax Department with assessees, especially in regard to—

- (i) provision of free advice to small assessees on the following points:
 - (a) maintenance of accounts in a form acceptable to the Income-tax Department; and
 - (b) matters such as filing returns of income, claiming refunds, facilities for tax payment, expeditious disposal of assessments, etc.
- (ii) provision of information on various matters relating to assessment proceedings, such as disposal of refund applications, adjournment applications, examination of records, etc.,
- (iii) arrangement of work so as to obviate the necessity of assessees or their representatives having to wait in Income-tax Officers for unduly long periods; and
- (iv) securing of the largest measure of agreement on facts between the assessee and the department at Income-tax Officer level?

Greater effort has recently been made to establish closer association between the assessees and the Income-

tax Department. Public relations Officers have been appointed but in the large centres particularly co-ordination is still not effective and there will have to be a greater effort in this direction.

(i) (a) It is desirable to have accounts maintained in a standard form by which it is easy to secure the desired particulars. But while this standardisation of accounts can be achieved only over a period, unnecessary difficulties should not be created in the way of assesseees if the expectations of the Department are not fulfilled.

(b) The individual assessee who is not well-versed, particularly the smaller traders, have considerable difficulty in filing returns, claiming refunds and asking for spread of tax payments over a period. In all such cases the Department should help the assesseees in complying with their requirements.

(ii) At present it is very difficult to get any typed copies of assessment proceedings or assessment orders and as a rule there is an unwillingness on the part of the Department to dispose of quickly refund applications. A time limit should be fixed for this purpose. Besides, there is disinclination also to take up cases where refunds are involved and assessments are unduly delayed. There is also an anxiety to examine accounts in detail in these cases and disallow items as far as possible. We urge, therefore, that a constructive approach should be adopted and that the Department should not be specially concerned where taxes are due and otherwise when taxes have to be refunded.

(iii) Either due to lack of suitable personnel or because of an incorrect understanding of the cases involved it has not been possible to arrange work in such a way that the necessity of waiting could be obviated. There is greater awareness at the present moment. But more officers are needed. It would also be appreciated if the difficulties of assesseees are more seriously considered. There are even no waiting rooms or facilities for assesseees to await their turn and keep their books, etc.

(iv) The largest measure of agreement on facts between the assessee and Department can be secured at Income-tax Officer level if there is an open mind and a disposition to go through the books. Instead of picking holes, if the whole case is studied first and then in detail later, points of dispute could be reduced greatly in number. The procedure of disposal through affidavits can be adopted.

Question No. 98.—*What changes would you suggest in the existing arrangements relating to:*

(i) issue of notices; (ii) simplification and filing of returns; (iii) levy of penalties; (iv) recovery of tax; and (v) appellate procedure and machinery, particularly with reference to administrative control over Appellate Assistant Commissioners?

(i) Notice should be individually addressed in view of the importance of the assesseees concerned. As at present the liability should not be placed on the assessee if a public notification is not taken cognisance of and the forms from the Department are not received in time. Sufficient time for submitting the return should also be given.

(ii) More recently the Department has recognised the need for simplification of forms and filing the returns. Hitherto, a common form has had to be filed. This, besides involving the use of unnecessary stationery has had a confusing effect. If the various assesseees could be classed into different classes and appropriate forms could be devised, disposal will be greatly facilitated. Even the new forms decided upon recently are not freely available. Greater publicity should be given to the decisions of the Central Board of Revenue.

(iii) The levy of penalties should not be resorted to lightly and except in very severe cases no deterrent penalties should be imposed. We believe that in no case, the penalty should exceed 50 per cent. even in regard to Assessments under Section 34. Also, the automatic imposition of penalties and issue of notices should not be done by the Income-tax Officer in consultation with the Appellate Assistant Commissioner. Only the Tribunal should have the powers to impose penalties.

(iv) As has already been suggested, the Income-tax Department should have a machinery of its own and there should not be that lack of co-ordination between Certificate Officers and Income-tax Department as at the present moment. In fact, there is great confusion now about payments received from the assesseees towards tax dues and issue of receipts. Even where tax refunds are due corresponding adjustments are not made and the Certificate Authority is not duly notified. It will greatly facilitate the recovery of arrears of taxes if the Department itself can handle these matters and establish direct relations with the assesseees. Only in the last resort Certificate Officers should come into the picture. The Appellate procedure and administrative control over Appellate Assistant Commissioner should be laid down by the Ministry of Law. There should thus be separation of the judiciary from the executive.

Question No. 99.—(a) *Do you think that undue delay occurs at present in the course of assessment proceedings? If so, what do you attribute this to and what are your suggestions for remedying this?*

(b) *In order that delays of the kind mentioned above do not appreciably affect collection of a substantial portion of the tax due, should any special concessions be provided to assesseees to induce them to make advance payment of tax?*

NOTE.—*Some of the above questions were considered by the Income-tax Investigation Commission. If you have any remarks to offer on any points raised by them, they may be included in your replies to this part of the questionnaire.*

Assessments should be speeded up considerably. Income-tax Officers should work in greater peace and have the necessary assistance at their disposal. Files are not regularly maintained. Assesseees also should be given an opportunity to discuss the matter in confidence. Particularly in the bigger centres, Income-tax Officers have been crowded in large rooms and there is loud discussion leading to disclosure of secrets and confusion in thinking. If functioning of the Department could be better streamlined, the assesseees will be greatly helped. Simply because the Department is not in a position to expedite assessments it should not be made obligatory on the part of assesseees to pay a substantial portion of the taxes due. It may, however, be indicated that in the case of assesseees who are willing to pay the taxes, special concessions will be given, such as payment of interest on deposits or rebate on taxes on a percentage basis.

Special Business Taxes.

Question No. 100.—*What, in your opinion, would be the circumstances which would justify the levy of Excess Profits Tax or special business taxes?*

In our opinion, the levy of Excess Profits Tax or Special Business Profits Taxes is extremely unjustified. The Excess Profits Tax imposed in World War II no doubt brought large revenues to the Government. But the established industries particularly have suffered grievously on account of this imposition and the rehabilitation programme is suffering greatly now. In exceptional conditions there is probably a case for higher taxes in the order to enable the Government to derive a share of the profits arising out of exceptional conditions. But E. P. T. is so bad in principle and regressive in incidence that it should not be reimposed at any time. It has penalised efficiency and encouraged undesirable methods of expenditure leading to distortion of the cost structure. As for Business Profits Tax, the disastrous effects of Mr. Liaquat Ali Khan's levy in 1947-48 are vivid in the minds of the Government and assesseees. There is no case for its imposition as it has all the disadvantages of Excess Profits Tax and particularly in present conditions a demoralising effect on capital formation.

Death Duties.

Question No. 101.—*What are your main reactions to the Estate Duty Bill at present before Parliament?*

The Estate Duty Bill, which has become law should not have been brought before Parliament in the present conditions. Only when the national income is very high and it is considered necessary to bring about equality in the level of income and wealth, the Estate Duties could be levied. In fact Indian Society is so constituted that only succession or inheritance duties can be levied after a period of years. The effect of Estate Duties will be only to create disturbances in the economic structure with unfavourable effects from the long-term point of view. Immediately, there will be no improvement in the general conditions of the masses.

Question No. 102.—*Would you in the matter of rates of levy differentiate between self-acquired property forming the estate of a deceased and property inherited by him?*

If estate duties are to be levied at all there will have to be a differentiation in the matter of rates of levy between self-acquired property forming the estate of a deceased and property inherited by him. This will at least retain the incentive to earn. In fact we would go so far as to suggest that any property can be assessed to estate duties only after it has passed hands at least once. If these suggestions were adopted the incentive to accumulate wealth will be encouraged and the regressive nature of the estate duties will be overcome especially as the principle of succession or inheritance duties will be satisfied at least up to one stage. In any case, there is need for a downward revision of duties when they are levied.

PART III—COMMODITY TAXES (CENTRAL AND STATE) CUSTOMS.

Import Duties.

Question No. 103.—*Do you think that any changes are necessary in the Indian Customs Tariff in respect of—*

(i) *grouping of commodities;*

- (ii) additions to and alterations in tariff items;
- (iii) correlation with the Import Trade Control Schedule;
- (iv) clarification in nomenclature and in units of measurement or weight?

Changes are necessary in the Indian Customs Tariff in respect of—

(i) grouping of commodities. The policy in regard to the levy of duties on imports should be determined by the end use of the articles imported. For this purpose, it is necessary to have the classification in such a way that it is easily possible to know what are essential imports and what are required for direct consumption by the community and what items are required for processing or otherwise. It will be necessary for this purpose to have sub-groups within the main groups and indicate clearly what are industrial raw materials, semi-manufactured items for processing, consumer items, which are luxuries, not manufactured within the country, consumer goods imported to make good internal deficit, capital goods, auxiliary items, etc., etc. The changes will have to be so made that, as far as possible, an effort is made to conform to international classifications.

(ii) The present policy of indiscriminate levy of import duties is not helpful. It is, of course, difficult to form any definite idea regarding the relative importance of the duties on specified items as a source of revenue. No duties should, however, be levied on industrial raw materials, capital goods or semi-manufactured items required by industries for processing. It would be possible to make additions to tariff items if care were taken to itemise suitably Item No. 87 "All Other Articles not otherwise specified, including articles imported by post". Numerous items which have grown in importance over a period have been jumbled in this group and the incidence of the import duties has also not been on a rational basis.

(iii) The Import Trade Control Schedule has led to unnecessary difficulties as there is no proper relationship with the tariff schedule and very often doubts have arisen about the types of goods imported. There should be some permanent machinery which would be responsible for giving an authoritative ruling with regard to the relation of a particular article imported, with the tariff schedule.

(iv) International classification should be followed as far as possible, as indicated earlier. While standardisation of weights and measurements is desirable wherever feasible, where the usages are correctly understood they should be left undisturbed. The absence of any details regarding the quantum of imports in many cases in the present classification has made effective comparisons and a proper study of the trends in imports difficult.

Question No. 104.—(i) What considerations should govern the fixation of rates of import duties for different groups or sub-groups of commodities or for special tariff items?

(ii) Have you any modification to propose in the present rates of duties in the light of the considerations suggested by you?

(iii) Do you consider that import duties should be reduced in respect of any specific commodities in order to reduce the scope for smuggling?

(iv) Are there any cases within your knowledge where duties on the constituent parts are higher than on the finished product? Is there adequate justification, in your opinion, for this differentiation?

(v) Do you think that owing to high rates of duties the yield on any commodity has reached the point of diminishing returns?

(i) It may be necessary to derive large revenues from import duties for some considerable time to come. But suitable changes should be made in import duties with a view to improve working conditions for industries and bring about reduction in costs of production. The list of items should be properly scanned so that it is possible to pass on more effectively the incidence of taxation to the rural and semi-urban areas. There should also be effective co-ordination between fiscal and tariff policy.

(ii) The duties on imported raw cotton, capital goods, heavy electrical machinery, etc., should be abolished, to mention only a few. The anomalies in respect of duties on hand and power operated machines should be eliminated as also those pertaining to items which are likely to be confused with one another.

(iii) In the present conditions smuggling is not brought about mainly by high import duties. The quantum allowed under the Import Control Trade Schedule also has an important bearing. Besides, smuggling, even with reasonable duties is being carried out on a large scale on account of the existence of foreign pockets in this country and the presence of a large land frontier between India and Pakistan.

(iv) There are many cases where the commodities on the constituent parts are higher than on the finished product, as for instance, in the case of the Automobile industry because protection is intended to be given for the manufacture of particular items. But there are other cases where, as for instance in chemicals, the duties are having a deterrent effect and industries have suffered thereby. The necessary modifications in those cases should be made. It is more important, therefore, to define clearly the purpose of the high import duties on commodities and determine periodically whether the desired results have been obtained.

(v) As indicated above it is very difficult to state in the present circumstances whether the high rates of duties on commodities have been responsible for reaching the point of diminishing returns. In the past few years the trend of imports has been rather erratic while the administration of import control measures has not been on the desired lines. However, in view of the fact that *per capita* consumption of many items in this country is low, so long as the import products are not highly priced and the tariff policy is helpful, the stage of diminishing returns may not be reached for sometime yet. It might be stated, however, that in the case of luxuries which become necessities over a period, as for instance in the case of motor cars, if the policy of protection-cum-subsidy could be followed, the development of Indian industry on particular lines could be ensured while the market for motor cars and trucks is expanded. There is no doubt that the prohibitive cost of cars and trucks has been responsible to an important extent for the poor Indian demand.

Question No. 105.—Is the relative use of ad valorem and specific duties in the Indian Customs Tariff satisfactory? If not, in what respects would you enlarge or restrict the scope of application of either, whether used singly or in combination?

The importance of the use of ad valorem or specific duties on imports is dependent on the objective of the authorities. If the revenue aspect is mainly emphasised, ad valorem duties will be found advantageous in a period rising prices. It may be so stated, in these cases, the ad valorem duty or specific duty is payable whichever is higher. This provides an adequate safeguard against undervaluation if there is an attempt in that direction.

In regard to protective duties, however, it is better to be more specific as price fluctuations might defeat the purpose of protection when there is a sharp decline in import prices and ad valorem duties happen to be levied. In these cases where it is clear that internal costs are rigid and protection on a definite scale is necessary specific duties might be levied.

Even though protective duties are levied, the bulk of the duties are for revenue purposes. It is, therefore, necessary to use ad valorem and specific duties in combination where it is not possible to distinguish between the various items and there is difficulty in respect of valuation or scope for evasion.

Question No. 106.—(i) In what circumstances would you consider "tariff values" a satisfactory basis for assessment of import duties? (Section 22 of the Sea Customs Act).

(ii) Are there any commodities to which you would extend the application of "tariff values"?

(iii) What changes, if any, should be made in the procedure for determining "tariff values"?

Tariff values have their use only from the administrative point of view. Also, where there are difficulties in valuation. In a period of stable prices tariff values are probably convenient. But in a period of fluctuating prices they may operate invidiously as when prices are rising an importer coming in later or has arranged his deliveries conveniently might actually pay lower rates. Revision of Tariff values is actually delayed and an extension of this system, even though desirable from the point of view of administrative convenience, might lead to sacrifice of revenue. As has been pointed out appropriately ad valorem duties with tariff values are in effect specific duties for the period during which there is no change in tariff value. Tariff values, if they are found necessary, when valuations present difficulties and/or complications, should be extended only to commodities on which duties are levied for revenue purposes and no protective element is involved.

There must be a defined procedure for fixing tariff values especially in times of changing prices. When conditions are normal the average of prices over a longer period, say three years, may be adopted but when prices are fluctuating violently the average of prices for six months should be adopted. There should be a committee of official and business representatives for this purpose and this should meet periodically.

Question No. 107.—(i) What changes in your opinion are necessary in the present provision (Section 30 of the Sea Customs Act) regarding the determination of "real value" and why?

(ii) Would you suggest any specific measures to counter the evasion of import duties through deliberate under-valuation?

(iii) Have the methods of valuation in the Sea Customs Act proved satisfactory in relation to trade through the land customs border, especially on the Indo-Pakistan border? If not, have you any specific suggestions to make in this regard?

More definite procedures for determining "real value" by Appraiser is necessary. Even though it is desirable to prevent undervaluation and ensure to the Exchequer proper collection of revenues, it is found in practice that where the appraiser interferes there is payment of higher duty and the adoption of wholesale prices at the port of entry for valuation purposes leads to the payment of larger sums where *ad valorem* duties are involved. The customs authorities should as far as possible ascertain prices ruling in export markets and attempt to effect fair assessment where genuine cases are involved. It is in any case necessary for the customs authorities to build up an organization, as indicated earlier, which will devote special attention to the difficulties encountered by them and keep track of developments in countries abroad. Ordinarily, C.I.F. prices should be taken into consideration for assessing "real value".

Question No. 108.—What changes would you suggest in the matter of granting exemptions from, or reductions in, import duties especially in regard to:

- (1) raw materials used for essential industries;
- (2) materials used for scientific research;
- (3) materials imported for charitable and humanitarian purposes;
- (4) materials imported for stimulating desirable activities, such as agricultural development; and
- (5) necessities of life?

The raw materials used for essential industries should be exempted from import duties as also material used for scientific research and charitable and humanitarian purposes. Materials imported for stimulating desirable activities, such as for agricultural development could be brought in either free or on payment of small duties while necessary supplies could be taxed to secure revenues as well as enable a shift in the incidence of tax burden to a larger section of the community than at present.

Question No. 109.—To what extent do you think revenue might be sacrificed in the interests of bilateral or multilateral fiscal arrangements such as GATT or the preferences in favour of certain Commonwealth countries?

The objective in these cases is to promote the volume of trade consistently with providing the necessary encouragement to Indian interests. Preferences have not been helpful to any great extent. In regard to GATT also the experience has not been satisfactory and we are against India continuing to be one of the signatories.

Question No. 110.—Under what circumstances should customs duties be used in preference to import quotas as a means of restricting imports?

When the balance of payments position is not unfavourable and it is intended, as at present, to regulate consumption of unwanted items, deterrent duties may be levied on certain classes of imports in preference to import quotas.

Question No. 111.—In what respects should the present law regarding "draw-backs" and "warehousing" be altered in order to assist the export trade in manufactured goods which involve the use of imported raw materials?

The present arrangements regarding draw-backs and warehousing should be modified in such a way that the necessary adjustments could be made more easily. In the case of cotton textiles considerable complaints have been made about the delay in getting the refunds of the duties paid on imported cotton while it has been necessary to continue to purchase further quantities involving large capital outlay. Similar is the case in regard to the cashewnut trade.

Question No. 112.—Have you any suggestion to make regarding the administration of the Sea and Land Customs Acts, especially in regard to—

- (a) facilities for settlement of disputes arising out of appraisement;
- (b) penalties imposed under the Act and the appellate procedure relating to them?

It sometimes happens that one consignment contains 3 or 4 items of different categories while the dispute relates to only one of them. In such cases the whole of the consignment is detained by the customs authorities and subjected to wharfage. There are also the usual risks involved in keeping the goods in the docks. It is, therefore, suggested that in such cases only those items under dispute should be detained and the balance released.

In the ordinary course the appellate authority is the Collector of Customs where the actual assessment proceedings are conducted by a Customs Collector who is ordinarily an Assistant Collector of Customs. In complicated cases this Officer takes the advice of the Collector of Customs before issuing orders. On appeal, the case comes to the Collector of Customs and since he will have already made up his mind earlier, the appeal becomes a farce. Again sometimes, when an appeal is pending, a Collector of Customs who has handled the case is promoted to the Central Board of Revenue and the order which he has passed earlier in his capacity as Collector of Customs comes to him. He is naturally prejudiced and so the case tends to be decided against the assessee. It is therefore suggested that the appellate authority with regard to the cases dealt with by the customs authority should be Central Board of Revenue. It should be a fundamental principle that no appeal should be heard by a man who has dealt with the same case at a lower stage.

At present the Finance Secretary has got powers to revise a decision given by the Chief Customs authority in a dispute under the Sea Customs Act. As in the case of the income-tax there should be an independent appellate tribunal to hear the decisions of the customs authority. Again, in levying penalties the rigour of penalty sometimes increases with the successive penalty cases. It is suggested that there should be a time limit whereafter a particular penalty imposed upon an importer is not taken into consideration in deciding the quantum of penalty in subsequent cases.

Importers are also harassed by the Customs authorities by adopting dilatory tactics in implementing the decisions of the Courts. It is essential to ensure that the judgment of the Courts is carried out promptly and faithfully.

Question No. 113.—Under what circumstances, in your opinion, should export duties be imposed?

Export duties should be imposed only as anti-inflationary measures and the Government, except in very few cases, should not except to derive any large revenues from exports of manufactured items particularly. It has been already indicated in our answer to Question 8 that the levy of export duties on jute manufactures, coal and cloth has had a discouraging effect on exports and that in the case of the former two industries particularly legitimate profits due to them have been denied and the Exchequer has benefited at their expense.

Question No. 114.—What measures would you suggest to achieve greater flexibility in the rates of duties to accord with the changing conditions of export markets?

As far as possible the rates of duties should be fixed on an *ad valorem* basis as specific duties have had a crippling effect in a declining market. Besides, a Committee of the Commerce and Finance Ministries should be constantly watching the trends in the export markets and effect changes in export duties as and when necessary. Since unnecessary speculation will be encouraged by frequent consultation with the interest concerned it has been suggested that the Government have not found it possible to have intimate contacts with industry and trade for this purpose. But in view of the importance of the questions at issue and the need for ensuring continuity in exports it is very necessary to have a special machinery for this purpose, as indicated above.

Question No. 115.—Would you suggest that the whole or a part of the receipts from certain export duties should be founded for financing schemes for promoting long range development of the export trade, subject to the obligations under GATT?

The receipts out of export duties can be used partly for financing schemes for promoting long range development of export trade as a whole, though special consideration should be given to the industry which contributes substantially to the revenues. In the case of export duties levied on manufactured items, however, funding can be done with the definite object of refund to the industries concerned when in difficulty. The jute industry particularly has been responsible for earning for the Exchequer over Rs. 150 crores in 1949-52 while it has not been able to earn for itself even reasonable profits. It has naturally been urged that a part of this income should be given back to the industry in order to enable it to get through the rehabilitation programme.

Question No. 116.—Would you, in the interests of revenue or from any other point of view, recommend increased participation by the State in import and export trade? If so, what form do you think should such participation take?

Notwithstanding the recommendations of the State Trading Committee there is no case for the State to participate to an increasing extent in the import and export trade. In particular cases, however, the State can handle imports, as for instance grains, fertilisers, etc. Even here it is our considered opinion that private importers can handle the trade more efficiently and

that there could be a considerable saving in foreign exchange expenditure thereby.

CENTRAL EXCISES.

Question No. 117.—Do you regard as satisfactory the present selection of commodities for purpose of levying excise duties? If not, what changes would you suggest and why?

Excise duties have acquired great importance in the past two decades and it has been necessary to increase the revenues from this source as the receipts from customs duties were declining on account of the displacement of imports of cloth, sugar, steel, paper, etc. As the Indian industries grew in stature it was necessary to impose countervailing excise duties. Besides, the needs of the Government increased and it was found as a source of revenue from indirect taxes excise duties were an ideal medium. The increase in receipts of excise duties in the past two decades will be evident from the table given at the end. There is some complaint in regard to the administration of excise duty on tea and tobacco. These may be looked into.

There is scope, however, for extending the list of excised commodities. New excise duties can be levied on the manufacture of footwear (organized section of the industry).

Question No. 118.—(i) Have you any changes to suggest in the present rates of excise duties?

(ii) Are the provisions regarding valuation satisfactory where *ad valorem* excise duties are levied?

(i) The excise duty on sugar has had a discouraging effect on consumption and it has not been recognised fully that the unscientific policy in regard to fixation of prices for sugarcane, the levy of cess and the excise duty have unduly inflated costs of production. In regard to cloth as well the conversion of the *ad valorem* duties into specific duties have become more onerous. (These have since been reduced.) The authorities were anxious to secure their revenues by doing away with *ad valorem* duties which presented administrative difficulties. The imposition of specific duties with the removal of control measure and the decline in prices have actually become unbearable and one of the main reasons for cloth not moving into consumption as freely as it should is the levy of specific duties. There is need to secure as large revenues as possible but not at the expense of consumption.

(ii) The difficulty has been felt in regard to the administration of specific duties on tobacco and there is confusion. The administration has tightened up regulations but it would be helpful if *ad valorem* and specific duties are combined judiciously. If this were done the yield could be very much more than now even with the existing rates.

Question No. 119.—Do you think that the differential rates of duty on different types of unmanufactured tobacco, other than flue-cured, should be replaced by a uniform rate of duty? Have you any other suggestions regarding the tobacco excess tariff?

The differential rates of duty on different types of unmanufactured tobacco, other than flue-cured, are inevitable to a certain extent as there is a considerable difference in the types of tobacco used for various purposes. The number of categories, however, could be reduced as it will facilitate administration and not afford much scope for corruption to the Excise Department.

Question No. 120.—Do you think that the lower rate of duty on the cottage match industry has been helpful to its development? If not would you suggest any change in the existing rates of duties?

The lower rate of duty on the cottage match industry would have been helpful to its development if the organised section were not competing so effectively. Even if the existing rates of duties are completely removed it is doubtful whether the cottage match industry will thrive. Other measures will have to be devised such as the provision of splinters, chemicals, etc., in a convenient form.

Question No. 121.—Do you think that the arrangements for the assessment and collection of excises in respect of manufactured and unmanufactured commodities require simplification? In particular, please comment on the present system as regards:

- (a) licensing,
- (b) warehousing, and
- (c) transport

of excisable commodities.

Bond facilities, licensing, etc., have been helpful in realising the revenue for Government. But in particular cases hardship is involved as for instance in the tea trade both in regard to drawback as well as payment.

Question No. 122.—Do you agree that a part of the proceeds of excise duties may be earmarked for ex-

penditure on research and development schemes designed to improve the quality and marketability of the commodities?

Where no cesses are levied a part of the proceeds of excise duties may be earmarked for expenditure on research and development schemes. Provincial cesses have not been found helpful as in the case of sugar. It will be necessary to co-ordinate the activities of the Central and State Governments in this regard. But there can be no special levy or earmarking for purposes unconnected with the industry concerned. The levy of a cess on mill cloth to promote the handloom industry is undesirable.

Question No. 123.—Do you think that the imposition of excise duties has affected adversely the development of industries producing excisable commodities, e.g., their size and competitive capacity in export markets?

In so far as heavy excise duties in the case of cloth have had a discouraging effect on consumption the industry has not been able to utilise its capacity fully and lower its cost of production even though it has succeeded to a great extent against serious odds. Particularly in the case of industrial alcohol the policy of the Government has been unhelpful as the capacity for production has not been fully utilised. It has not also been possible to compete in foreign markets effectively. The necessary changes should, therefore, be made. It is also necessary to ensure that the rebate of excise duties in the case of exports of excised commodities should be expeditiously granted.

SALT DUTY

Question No. 124.—Would you recommend the re-imposition of the excise duty on salt? If so, on what conditions?

We have already indicated in our memorandum submitted to you that the salt duty should be reimposed. This is the only tax which can reach the vast masses and compel them to contribute liberally towards the developmental expenditure which has been incurred on a large scale and which will benefit the rural side to a great extent. As has already been emphasised by us the salt duty should be reimposed to yield a larger revenue and the proceeds should be specifically earmarked for expenditure on productive purposes under the Five Year Plan.

TAXES ON THE SALE OF PURCHASE OF GOODS AND ON ADVERTISEMENTS.

Question No. 125.—Under the Constitution, the only sales or purchases which can be taxed are sales or purchases of goods. Do you consider that the sales tax should be extended to—

(i) services, so that the tax may be leviable on (a) charges for services proper (e.g., bills from a goldsmith or a printer), (b) charges for both services and goods where the two cannot be readily separated (e.g., hotel bills) and (c) charges for certain types of goods into the price of which service enters as a substantial element (e.g., paintings or photographs); and

(ii) transactions of sale or purchase in stock exchanges and futures markets?

(i) (a) Sales tax should not be levied for services proper in whatever form.

(b) Neither for both services and goods as they cannot be readily separated, and

(c) Certain types of goods of which service enters as a substantial element.

(ii) In view of the peculiar conditions in this country and the need to encourage stock exchange activity as far as possible no tax should be levied. In respect of futures transactions also no taxes should be imposed.

Question No. 126.—(i) The Union alone has the power to levy tax on sale of newspapers or on advertisements in them. This power has not, so far, been exercised. Would you propose as desirable and feasible (a) a tax on sales only or (b) a tax on advertisements only or (c) a tax on both?

As regards (a), it has been urged that, on account of the small price charged for each newspaper, the sales tax would be fractional and cannot be passed on to the buyer, whereas in the aggregate it would be an undue burden on the concern itself. If you agree with this, how would you meet the difficulty?

As regards (b), what classes, if any, of newspapers or advertisements would you exempt from the tax, and what rates of tax, graded or other, would you levy?

In the present conditions of the Fourth Estate, tax on sales of newspapers or on advertisements or both should be considered unwise. We are also opposed to taxation of advertisements other than those appearing in newspapers.

Question No. 127.—As regards sales generally and in particular the sales tax on goods leviable by the

States, it is sometimes argued that—since all goods sold in a State must fall within one of three categories, viz., (a) manufactured or produced within the State, (b) transported into the State from elsewhere in the country and (c) imported into the State from abroad—an extension or increase of excise would serve just as well as sales tax for category (a), of octroi or terminal tax for category (b), and of customs for category (c). Do you agree with this view which implies that the sales tax has no specific function to perform in the country's system of taxation? If not, what in your opinion, from the point of view of a correlated tax-structure, is the legitimate place and scope of the sales tax as distinguished from that of excise, octroi and customs?

An extension or increase of excise would not serve the purpose of sales tax as not all manufactured items are excised and it will be inadvisable to have a Central and State excise on one commodity. Besides, the ultimate incidence would be different. In regard to (b) the recent developments must lead to some solution while in respect of (c) the same objection as in (a) will be present. At the moment imports are brought into the country mainly through ports while their consumption is spread all over the country. We do not agree with the view that the sales tax has no specific function to perform in the country's system of taxation. In fact, we have been urging for bringing about uniformity in rates and systems as far as possible though there are practical difficulties. The sales tax performs an entirely different function from excise, octroi and customs and there is the advantage of a large coverage.

Question No. 128.—(a) Sales tax is almost invariably levied by the State Governments in terms of the turnover of the dealer over a given period. Since a sales tax leviable on the individual transaction necessitates fairly elaborate accounts, cash memos, etc., which only a small proportion of dealers is equipped to maintain, do you agree with the view that, in Indian conditions, the bulk of the sales tax is likely, for a long time to come, to continue to be leviable on aggregate turnover as distinguished from the individual sale-price?

(b) In most States there are separate laws governing sales tax on petrol. To what articles, if any, do you consider it desirable and feasible to extend the particular system adopted in respect of petrol?

It will be desirable to introduce methods by which sales-tax is levied on the individual sale price in the case of multi-point systems as the turnover will yield less taxes. There should not, in any case, be difficulties in regard to exemption. This will, however, not be necessary when the sales tax is single-point and not multi-point. While it is desirable to devise methods by which the maintenance of books is made compulsory in a particular form over a period in the present condition sales tax administration will have to be carried out in such a way that it does not operate harshly and at the same time fetches the required revenues.

We do not favour the existence of separate laws governing the levy of sales tax on particular items like petrol.

Question No. 129.—(1) In regard to a system of levy based on turnover, is the choice broadly limited to the alternatives hereafter mentioned or is there any other system you would advocate? Under the system you recommend would sales tax continue to be roughly as significant a source of State revenue as at present? The alternatives referred to above are:

(i) a relatively low rate of levy at each of almost all points of sale; few dealers excluded and few goods exempted (Multi Point);

(ii) a relatively high rate of levy at only one point, viz., the point at which a registered dealer sells either to a consumer or to an unregistered dealer to another registered dealer; exclusion from compulsory registration of a dealer below a certain limit of turnover; a large number of exempted goods (Single Point); (888) various combinations of the above.

(2) Which of the above alternatives would you advocate? Please state your reasons in some detail, comparing merits and demerits from the point of view of (a) the consumer, (b) the dealer, (c) industry, trade, etc., generally and (d) Government. Please relate your arguments, as far as possible, to lessons which may be drawn from the actual working of Sales-tax Acts in different States.

(3) In particular:—

(i) as regards (a) above, do you think that the sales-tax, or any particular form of it, leads to a greater burden being placed on the consumer than is accounted for by the proceeds which accrue to the Exchequer?

(ii) As regards (b) above, have you any suggestions to make regarding the simplification of forms,

accounts, etc., and of the procedure generally in order to make the administration of the tax less burdensome to the dealer? Further, having regard to the cost of maintenance of the machinery for compliance, would you suggest an alternative form of taxation so far as small dealers are concerned?

(iii) as regards (c) above, has the imposition of the sales-tax led to any noticeable change in the organisation of the trade in the country, especially in regard to the size of the business unit, location of head-offices, number of intermediaries, variety of the goods dealt with, etc.?

(iv) as regards (d) above, please examine the financial and administrative aspects, including the scope for evasion presented by the particular system and the difficulty or otherwise of counteracting it.

(1) (i) The system as it is now operating in West Bengal is found to be convenient and the list may be longer. Since the burden of sales-tax is ultimately passed on to the consumer the multi-point system would only add to the work of administration. The sales-tax will continue to be a significant source of revenue to the States as at present. In fact, its importance should increase over a period.

(ii) The single-point levy is the most convenient from the point of the Government as well as the consumer. The objection to the multi-point levy also lies in the fact that there are more stages than one and it has not always been possible to pass on the full burden of the tax to the consumer. Also, the consumer does not know what he is paying by way of sales-tax. It will also be possible to levy differential rates on particular types of commodities, if need be. By making responsible the registered dealers for collection at one stage, the Government will be able to deal with them properly. The consumer also will be able to know what he is paying by way of tax.

(2) The answer to this question has been partly given above.

(3) If sales-tax is levied correctly and collected by the States rigorously it cannot result in an addition to the burden to the consumer more than the amount of the tax. But if it is not collected fully by the State then the consumer is obliged to bear a heavier burden than is accounted for by the proceeds which accrue to the Exchequer.

While the character of the retail trade is still unorganised the development is towards better organisation in the larger centres and the registered dealers also are increasing in number. It has been suggested that the sales-tax can be made effective if it were made a purchase-tax. But the scope for evasion has been eliminated to a large extent with the recent decision of the Supreme Court in regard to inter-State trade. Besides, the payment of the purchase tax will lead to financial difficulties for the dealers and there might also be a slight variation in incidence.

Question No. 130.—In relation to the particular system you advocate:

(i) should there be special rates of levy, higher than the ordinary rate, for certain articles? If so, for which types or articles?

(ii) should there be special rates of levy, lower than the ordinary rate, for certain articles? If so, for which types or articles?

(iii) which articles, if any, should be exempted altogether and why? Please elaborate the principles which in your opinion, should underlie exemptions.

As far as possible it is desirable to have uniform rates over a large number of items.

Certain articles have been declared as essential articles of consumption under the power conferred on them by the Centre.

It has so happened, however, that many of the States are levying taxes on essential items and the position is such that it is not possible for them to shed the revenues from the sales-tax on these commodities. It is necessary, however, to exempt taxation of foodgrains, eatables like bananas, etc. More important is the need for exemption from sales-tax of industrial raw materials, e.g., sugar cane and cotton. As the tax results only in an increase in the cost of production and impairs competitive efficiency of the industry concerned, it will always be advisable to levy sales tax on the end products.

Question No. 131.—In regard to system, rates, exemptions, etc., what degree of uniformity between the different States do you consider desirable and feasible? Would you bring it about—

(i) by formal or informal convention;

(ii) by central legislation promoted at the instance of two or more States;

(iii) by constitutional amendment, so as to include certain basic matters connected with the sales tax in Concurrent list;

- (iv) by constitutional amendment so as to include the item of sales tax, as a whole, in the Union List? In the last-mentioned case how would you apportion the proceeds? Would this alternative be a practicable proposition from the point of view of the finances of the States?

As we have already indicated under answers to questions 127 and 129, it will be advisable to have a single point system and also agree in regard to the exemptions of essential items. Even if it is not possible to remove the taxes on essential commodities immediately it should be stipulated that the necessary adjustments should be made over a period. Conventions can be created only when there is greater co-operation between the States and as far as possible the questions relating to sales tax and other matters are discussed between the Central and State Finance Ministers in a conference. It will not be advisable to include the item of sales tax in the Union List because of the feeling already referred to that the Centre is having the cream of tax revenues and that excessive centralisation should be resisted. The States consider the revenue from sales tax as important and capable of adjustment. The limits however may be defined and a Central Model Sales tax Act should be followed.

Question No. 132.—To what extent has any desirable uniformity been achieved in regard to exemptions (in favour of "goods essential for the life of the community") under clause (3) of Article 286 of the Constitution? What principles would you advocate for deciding the exemptions to be made under this provision of the Constitution? Do you consider that the scope of the provision contained in Clause (3) of Article 286 should be extended also to "essential articles" which had been subject to sales tax before the relevant central enactment came into force?

The answer to this question has been partly given under answers to questions 130 and 131.

Question No. 133.—As regards "sales outside the State", "inter-State commerce", etc., please discuss the adequacy or otherwise of the relevant provisions of Article 286 and suggest remedies for any defects which, in your opinion, have been revealed in the actual working of these provisions.

- (b) Please discuss in this connection the desirability and feasibility of the suggestions that purchases only (and not sales) should be taxed, so that the tax jurisdiction of each State might be confined to parties residing within the State. Alternatively, do you consider that purchases should be taxed in certain cases and sales in certain others; if so, how and on what considerations would you define the two categories? In either case, please describe your scheme in some detail and explain the advantages which you claim for it.

(a) The levy of sales tax on inter-State trade has given rise to considerable controversy and recently the Supreme Court decided in favour of the States which import goods from other State giving the right to tax such sales. Since the transactions in the past have been carried out in the bona fide impression that they will not be liable to tax, retroactive effect, should not be given and the State should not insist on the exercise of their right. The Central Government also have circularised the States to the effect that retroactive effect should not be insisted upon. We feel that in respect of industry and trade the difficulty will not arise if there was central direction in respect of the collection of the sales tax in respect of inter-State transactions. It was estimated that 10 to 20 per cent. of the total trade was not paying sales tax while now with the sanction under the judgment of the Supreme Court the effect of sales tax will be regressive and inter-State trade, while it was encouraged previously, will be discouraged now.

(b) The desirability of taxing sales only in respect of transactions within the State and purchases only in respect of inter-State transactions may not solve the difficulties. The multi-point and single-point systems and the adoption of different practices as in Bombay or Madras have tended to have a confusing effect. On account of the liability imposed on sellers in respect of inter-State transactions, in pursuance of the Supreme Court's judgment to pay tax to the State in which the goods are consumed and the need to prepare returns and be answerable to the various States where sales tax is to be paid, inter-State trade will be seriously affected. In order to minimise the trouble to sellers and make it administratively convenient to the State in whose area dealers obtain goods from dealers in other States for consumption within the former's territories there should be some uniform principles. The States between themselves may agree on some form of arrangement which will not cause unnecessary hardship to dealers in respect of inter-State transactions.

While the claim for uniformity and centralisation has been violently opposed on the ground that the indi-

vidual requirements in terms of revenue are different there can be no denying the fact that there should not be any difference on the question of principle that the systems at least should be uniform, the States having the right to levy the rates of taxes as they like within specified limits.

Question No. 134.—Do you think that the lack of uniformity between the States as regards the rates of sales tax and the methods of applying it (single or multiple point) has the effect of raising the barriers in the inter-State commerce or of inducing un-economic diversions of trade? If so, what measures would you suggest to rectify the position?

It has already been indicated that the lack of uniformity between the States as regards the rates of sales tax and the methods of applying it have impeded inter-State trade. The flow of trade from areas which have a higher rate of sales tax should be brought about as far as possible and uniformity achieved not only in regard to the rates of tax levied on various commodities but also in respect of the system followed.

Question No. 135.—(a) In regard to State excise duties and the revenue therefrom, have you any comments or suggestions to make—

- (i) on features of importance connected with the system of levy of these duties in different States

or

- (ii) on policies involving various degrees of relinquishment in certain States of the revenue from these duties?

Should there, in this context, be uniformity between different States? If so, in what particulars and to what extent?

- (b) Is there proper co-ordination between the levy of Central excise on medicinal and toilet preparations containing alcohol, etc., and of State excise on alcoholic liquors? If not, what steps would you suggest to ensure adequate co-ordination?

In regard to State's excise duties and the revenues derived therefrom we have been repeatedly pointing out that the loss sustained on account of the introduction of complete or partial prohibition has been serious and that apart from incurring additional expenditure on the enforcement of prohibition policies it has been necessary for Bombay and Madras to forego considerable sums by way of revenue. The losses in these cases are as much as Rs. 25 crores. The main revenue is derived from liquors, toddy, wine and others while the yield from the tobacco duty in Madras is rather sizeable. The table (page 461) will indicate the loss sustained by Bombay and Madras particularly. There is no need for uniformity in the rates of levies though there should be agreement on policy and in the face of the admitted failure of the policy of prohibition in many of the States, it is not advisable to sacrifice valuable revenue. In respect of medicinal preparations there should be, however, uniformity in levying State excise duties.

Question No. 136.—Do you think there is a case for vesting in the administration the power to alter, by executive order, the rates of import duties, export duties and excise duties? If so, please indicate in what circumstances and within what limits such power should be exercised?

The rates of import duties, export duties and excise duties have to be varied according as circumstances dictate and the Executive can make the changes in consultation with the Committee that should be created, as suggested by us, with the definite directions that Parliament's sanction should be secured later. It need hardly be emphasised that the administration of export duties particularly has not been calculated to be in the interests of the industry or trade concerned and that the decisions regarding a decrease have always been taken after considerable delay.

Question No. 137.—Do you visualise any scope for extension of the field of commodity taxation as a result of the implementation of the Five Year Plan?

As indirect taxes will afford the best source of revenue the authorities should be constantly exploring the possibilities for the extension of commodity taxation though there should not be any disposition to anticipate a situation.

Question No. 138.—What "luxury" articles, if any, would you suggest on which commodity taxes in any of the various forms might be levied at specially high rates?

We have already indicated that luxury imports might be allowed on the payment of higher duties instead of prohibiting them completely. The list of articles will have to be determined in the light of existing conditions and internal availability.

STATEMENT OF REVENUE FROM CENTRAL EXCISE DUTIES, 1937-38 TO 1953-54.

(In lakhs of rupees.)

Excise duties on	1937-38	1938-39	1939-40	1940-41	1941-42	1942-43	1943-44	1944-45	1945-46	1946-47	1947-48*	1948-49	1949-50	1950-51	1951-52	1952-53 (Budget Estimates)	1953-54 (Budget Estimates)
Motor Spirit	1,22	1,20	1,07	1,81	1,71	2,57	40	18	2,27	1,79	74	1,42	1,78	2,07	2,07	2,00	2,05
Kerosene	76	67	32	71	64	70	53	48	35	27	16	20	23	28	26	25	25
Sugar	3,33	4,23	2,49	3,91	6,72	4,87	7,24	7,76	5,84	6,97	2,86	6,46	7,32	6,48	8,43	9,25	11,55
Matches	2,00	2,18	2,24	2,27	2,90	3,32	4,71	5,37	6,44	4,42	3,22	7,30	7,57	8,07	8,69	9,00	9,00
Iron and Steel	35	37	40	49	52	50	59	52	52	49	30	46	52	54	55	60	60
Coal and Coke . . . . .	..	..	..	30	32	25	23	1,32	3,47	3,57	74	1,02	1,32	1,62	1,66	1,70	2,00
Mechanical Lighter . . . . .	..	..	..	..	..	..	..	2	..	..	..	..	..	..	..	..	..
Tyres . . . . .	..	..	..	..	35	56	83	1,14	1,24	68	62	1,98	3,57	4,04	6,09	4,80	5,25
Tobacco . . . . .	..	..	..	..	..	2	9,47	17,12	20,72	20,31	11,57	25,46	28,23	32,01	35,55	34,00	35,00
Vegetable products . . . . .	..	..	..	..	..	..	94	1,11	1,33	1,27	74	1,97	2,28	2,19	2,45	2,75	2,90
Betel Nuts . . . . .	..	..	..	..	..	..	..	1,30	1,80	76	21	..	..	..	..	..	..
Tea . . . . .	..	..	..	..	..	..	..	1,50	1,90	2,11	2,09	3,66	2,54	3,35	4,31	4,00	4,25
Coffee . . . . .	..	..	..	..	..	..	..	16	33	23	1,02	49	50	1,17	77	70	75
Cotton cloth . . . . .	..	..	..	..	..	..	..	..	..	..	..	89	12,32	9,26	16,36	12,00	21,00
Miscellaneous . . . . .	..	..	..	..	..	..	..	21	15	16	15	35	34	2,44	42	35	40
Deduct refunds . . . . .	..	..	..	..	..	..	..	..	..	..	16	1,01	62	3,96	1,83	1,40	1,00
Total Receipts	7,66	8,65	6,53	9,49	13,15	12,79	24,94	38,14	46,36	43,03	24,26	50,65	67,90	67,54	85,78	80,00	94,00

* Figures relate only to the period 15th August, 1947 to 31st March, 1948. Figures prior to 1947-48 relate to undivided India
Source : Report of the Finance Commission, 1952, page 196 and 197 and Central Budget Memorandum 1953-54.

PROVINCIAL EXCISE.

(In lakhs of Rs.)

State	1933-34	1938-39	1946-47	1948-49	1950-51	1952-53*
Madras	4,29	3,72	14,68	3,67	55	3,27
Bombay	3,64	2,90	9,74	6,17	1,07	2,79
Bengal (a)	1,34	1,59	6,42	6,22	6,20	6,99
U. P.	1,33	1,33	6,74	6,53	6,51	8,89
Punjab (a)	94	1,02	3,32	2,38	2,08	2,98
Bihar	1,24	1,20	5,15	4,85	5,26	6,53
M. P. (C.P. and Berar).	57	64	2,24	2,19	2,31	3,39
Assam (a)	35	35	82	95	93	1,48
Orissa	—	33	1,11	1,36	2,13	2,56

* Including States' share of Central Excise Duties.
(a) Figures upto 1946-47 relates to undivided provinces.

PART IV.

AGRICULTURAL INCOME-TAX, LAND REVENUE & IRRIGATION RATES.

Agricultural Income-tax.

Question No. 139.—A few States levy agricultural income-tax, but in almost none is it among the more important sources of revenue; the progress of land reforms will further reduce its yield. Would you, in order to increase the yield from this tax or for other reasons (which may please be specified), make major modifications in the present system of taxation of agricultural income? If so, please indicate the modifications you would make?

We have already indicated in Part I that the revenue from agricultural income-tax is rather low and that there has been no disposition to levy tax in many of the States. Presently, agricultural income-tax is levied only in West Bengal, Assam, Bihar, Orissa and U.P. in Part A States. The yield is negligible being only Rs. 4 crores in 1952-53. The details are as below:—

	1952-53 (Budget) (In lakhs of Rs.)
Assam	71
Bihar	40
Orissa	15
U. P.	98
West Bengal	64
Hyderabad	10
Rajasthan	15
Travancore-Cochin	85
TOTAL	3,98

While it is true that the progress of land reforms will result in reduction of individual incomes, the revenue from agricultural income-tax could nevertheless be made more impressive by introducing a sliding scale with a mild progression in rates. Land taxes should be allowed as expense and due consideration should also be paid to the possibility of a fluctuation in incomes over a period due particularly to failure of crops, attack of pests, etc., abnormal changes in prices, etc.

Question No. 140.—In particular, do your suggestions involve—

- correlation, and if so, to what extent, of agricultural with non-agricultural income-tax;
- alteration, and if so, in what manner, of the levy of land revenue?

As regards (a), if the correlation suggested takes the form of the levy of a single tax on the total of non-agricultural and agricultural income, instead of the present separate Central and State taxes, please deal with the constitutional, administrative, and other problems involved, including the apportioning of proceeds among State Governments. Alternatively, if the State Governments continue separately to levy a tax on agricultural income, but the rates of levy are based on the total of the two types of income, agricultural and non-agricultural, what are the specific problems which arise, and how would you deal with them?

As regards (b), please indicate the probable net effect of the suggested measures on the revenues of Government. What administrative or other issues are involved, and how would you deal with them?

Our suggestions do not involve co-relation of agricultural with non-agricultural income-tax. Land revenue will always have to be levied as, with the fragmentation of cultivable land and the possibility of wider distribution than at present, the only way of reaching the masses will be through the land tax.

We are not in favour of the co-relation of agricultural and non-agricultural incomes with a view to levying a single tax and apportionment of the proceeds to the States concerned. The second procedure, namely, that of levying separate taxes, would be more welcome as it will enable the States to get their revenues without any difficulty. A Central Model Act can, however, be framed so that an attempt towards uniformity can be made.

Land revenue will have to be secured as at present through land taxes; but, as indicated in our reply to Part I, the incidence of land tax varies considerably in various States, not to speak of the fact that as between various crops the burden of tax has not proved to be equitable. While the administrative machinery cannot cope with the work, the discretion allowed for fixing rates has resulted in a loss of revenue. Besides, the system of land tenure varies with the States and even within the States and rates under ryotwari system are stated to be the highest particularly in Madras. In order, therefore, to secure revenue on a larger scale than at present, the first attempt should be towards uniformity in the levy of land tax or at least in ensuring uniformity in incidence. (See table at end.)

Question No. 141.—How would you determine taxable income in the comparative absence of accounts in rural areas? What treatment should, in particular, be given to the following:—

- Expenses of cultivation, harvesting, preparation for the market, etc.;
 - agricultural losses owing to a calamity or other reasons;
- (In this connection, would you favour giving the assessee the discretion to choose the alternative of averaging his income over a number of years—say 3 to 5 years—in order to cover good and bad years?)
- depreciation in respect of:—
 - live-stock,
 - implements and carts,
 - means of irrigation, e.g., wells, etc.,
 - buildings?

Taxable income can be determined only in relation to the prices that prevailed at the time of harvest. The State machinery for revenue collection will be helpful in this regard. In the case of own cultivation, full expenses should be allowed including wages in respect of individual work. Besides, the facility to average income should be given for a period of three years. Exceptional losses also should be allowed to be set off over a period. Depreciation in respect of live-stock should be given and it can be so indicated that encouragement will be provided for developing irrigation facilities by agreeing to allow a proportion of the taxable income for tax purposes.

Question No. 142.—What rates would you prescribe for agricultural income-tax and how would you graduate them? Is it possible to have uniform rates in all the States? What exemption limits would you lay down?

Agricultural income-tax will have to be levied on incomes above Rs. 5,000 and should be so graded that the maximum is not in any case above 25 per cent. It may also be stated that land-tax will be allowed credit as taxation paid at source. It is possible to have certain measure of uniformity in all the States though the graduations may be dependent on the nature and number of agricultural incomes.

Question No. 143.—For areas already under or likely hereafter to be brought under ryotwari or similar tenures, do you consider that land revenue policy should be based on some form of periodical settlement?

If not, what alternative would you suggest? How would you work it? What would be its probable net effect on Governments' revenues?

The need for uniformity of land tenures is felt more than ever important and it might be so arranged that when a change is made in the system of tenure the land revenue policy could be placed on some form of periodical settlement. As regards areas already under ryotwari tenures the present system of periodical settlement has not been found satisfactory. In fact, owing to the difficulties involved in effecting the settlement and the anxiety to eliminate earlier mistakes it has not been possible in Madras to revise land taxes for nearly 2 decades. Where new arrangements have to be carried out and an effort is made to raise large sums by way of land taxes, it would be advantageous if the necessary machinery could be evolved by which it is possible for Government to assure for itself a certain amount of minimum revenues and derive greater revenues in times of higher prices or agricultural prosperity. Because of the fact that no serious efforts have been made to collect larger revenues from land taxes and there is also an obvious disinclination to proceed fast, no single policy will be helpful. The Madras and Bombay Governments wanted to impose taxes on a differential basis in respect of food and cash crops and also to levy graded surcharges. But they did not proceed with the measures on account of political opposition.

Question No. 144.—If you are in favour of periodical settlements, what qualifications, if any, would you make in the practices and principles which have been hitherto and why? In your reply please refer in particular to the following:—

- (i) **Period of guarantee**—Should this be shorter than in the past? Would you suggest longer periods in special circumstances, e.g., when ryotwari tenure is introduced for the first time?
- (ii) **Scope of guarantee**—Should a fixed assessment be guaranteed for a specific piece of land (or for a proprietary body, as for instance, in the Punjab)? Alternatively should a basic rate be fixed and limits guaranteed within which it may vary? What factors would you take into account in varying the rate, e.g., area, nature of crop, yield, prices, etc.?
- (iii) **Basis of assessment**—How should the basic rate be fixed? Would you introduce an element of progression?
- (iv) **Incentive to production**—Would it be feasible so to regulate assessment as to provide an incentive for:—
 - (a) larger agricultural production;
 - (b) shifts in production, e.g., from cash crops to food crops or vice versa;
 - (c) capital improvements to land?
- (v) **Payment in kind**—Would it be possible to provide for payment in kind either partially or in full? Please discuss the advantages, difficulties, etc.
- (vi) **Uniformity between States**—In the application of these principles what degree of uniformity between different States would be desirable and possible?
- (i) **Period of guarantee** should be shorter than in the past. We agree that where changes have been made in the system of tenure a long period of guarantee might be given. But the objective should always be to achieve some measure of uniformity in the incidence of taxation.
- (ii) The rates fixed should be for particular areas which have more or less the same fertility in a given locality and which are covered by particular irrigation systems. In other cases, the rates are fixed in relation to the plots concerned with reference to nature of crop, yield, fertility, etc.

(iii) If agricultural income-tax is levied in all States, there is no need for introducing an element of progression in land taxes.

(iv) Apart from encouraging agricultural production in the manner indicated in answer to question 141 it will be difficult to encourage shifts or otherwise through land taxes though in the case of the small land holder the objectives would be achieved through constructive measures and in the case of capital improvement to land by remitting land revenue for a period of years.

(v) Payment in kind has its advantages in times like the present and an attempt has been made to try the levy systems. But there are practical difficulties and the attraction to pay in kind from the point of view of the cultivator is only at a time when prices are high. Besides, except when control over a period of years is envisaged and it is necessary to ensure that a portion of the production is being made available in kind for purposes of distribution, this system has nothing to commend itself. Also, conditions vary in the various States and even within the States it might so happen that the Government will be obliged to undertake obligations unnecessarily. If on account of difficulties or otherwise in particular periods, the cultivator expresses his desire to pay in kind and the Government will also be benefited, the system might have limited application.

(vi) In the present state of land taxation and the diversity of land tenures in various areas the above principle cannot be applied with equal force or validity. But, as has been repeatedly pointed out by us, it is necessary to have some measure of uniformity. There are practical difficulties. But efforts should be made over a period.

Question No. 145.—In regard to a re-settlement as distinguished from an original settlement, what additional principles, if any, would you suggest?

In regard to a re-settlement as distinguished from an original settlement it is necessary to eliminate the mistakes of the earlier settlements. The arbitrariness in the earlier settlements and the diversity in practices followed even within the State should be avoided. The guiding principle will, of course, be the change in agricultural prices over a period, the need for larger contribution to the revenues and the benefits conferred by the State in the form of additional irrigational facilities, or the like.

Question No. 146.—Where re-settlement is over due but cannot yet for administrative or other reasons, be undertaken, what transitional steps would you recommend in order to bring the old rates into conformity with changed conditions?

Would you levy a surcharge on the old rates, graduated if need be with reference to such factors as crop grown, size of holding, etc.?

How would you provide against the possibility of such a surcharge accentuating the disparity already present as a result of settlements of different areas having been undertaken at different times?

If the existing disparity is itself of a significant degree, what steps would you take to reduce it?

In Madras and other places resettlement has not been possible on account of administrative or other reasons. It has, therefore, been suggested that a surcharge should be levied and that, in order to make larger agricultural incomes bear their proper share, agricultural income-tax should be levied before any comprehensive arrangements are contemplated. Graduated surcharge can be levied only when it is not contemplated to enforce the agricultural income-tax on an effective basis. If the graduation is also to be made with reference to such factors as crops grown there might be practical difficulties in application and it will so happen that the rates fixed with reference to one set of conditions are not applicable to a changed set of conditions. It was complained some time back, that the structure of prices two years back was such as to encourage the growth of cash crops and divert land from food crops. The present conditions are, however, different and it has been indicated that in particular parts of the country it is more advantageous to grow foodgrains in place of cash crops. In these circumstances, graduated surcharges, having reference to such factors as crops grown, might prove to be not only difficult for administration but also inequitable in incidence.

The small hardships endured as a result of disparity consequent on mistaken settlement of different areas can be exaggerated. But it is a question more of those favourably affected enjoying undue advantages rather than those unfavourably affected suffering further hardships.

Question No. 147.—Since a certain degree of disparity may be present: (i) between the pre-existing and the newly merged areas of Part A States; or (ii) between the different units which have gone to form a Part B State; what steps, if any, would

you take, pending a general resettlement of such areas, towards removal or reduction of disparity?

In respect of pre-existing and newly merged areas in Part A States and different units which have gone to form Part B States those conditions obtaining in the greater portion of the State concerned should be applicable to the rest though the changes should be brought about gradually. In newly merged areas of Part A States surcharges should be levied to bring land taxes in line with those existing. In the case of different units merged into Part B States disparities must be eliminated on the basis of the greatest common measure of agreement.

Question No. 148.—Where, ryotwari or similar tenures are introduced for the first time, on the abolition of zamindari, but settlements cannot yet be undertaken, what interim steps would you take to regulate assessment?

In this connection, how would you deal with the following special problems:

- (i) fixation of post-abolition assessment with reference to (a) pre-abolition rent and (b) compensation payable by the State and/or the occupant;
- (ii) paucity of sufficiently detailed land records or of economical data, e.g., market rents;
- (iii) lack of trained staff required for work in regard to (a) land records, (b) new surveys and (c) new settlements?

Would these problems be present in an aggravated form in permanently settled areas, such as West Bengal?

Where new tenures are introduced on the abolition of zamindari system the practice obtaining in the surrounding areas in Madras and Bombay might be adopted. But in the case of U.P. and others it might be so stipulated that $2\frac{1}{2}$ per cent. to $3\frac{1}{2}$ per cent. of the income on the basis of the average for the last 2 or 3 years should be paid as land tax and specific rates determined as an interim measure.

(i) The problems mentioned in (i), (ii) and (iii) are certainly difficult of handling. But it should be possible to have some reliable information about previous rents which should be utilised as far as possible pending a general resettlement and the creation of suitable machinery.

Question No. 149.—Do you think that the principles of assessment of land revenue will require modification if co-operative farming is more widely adopted? If so, in what directions?

In view of the regular fragmentation of land holdings it is probably advisable to encourage co-operative farming in such a way that available land could be put to greater use. At the same time, individual ownership and interest should be preserved as far as possible. In these cases, a slightly lower levy may be made if there is a significant increase in the total agricultural income as a result of co-operative farming.

Question No. 150.—Have you any comments to make on policies in respect of:

- (i) alienation of land revenue in forms which such alienation subsists and may continue to subsist (e.g., devasthanams);
- (ii) concessions in land revenue, both ad hoc and regulated, e.g., on (a) sale of land belonging to or at the disposal of Government or (b) transfer of such land either or special tenure such as impartible or in-alienable tenure or on ordinary tenure to special classes of lessees such as educational or charitable institutions and co-operative societies; and
- (iii) suspensions and remissions?

Alienation of land revenue and concessions in land revenue will have to be continued in particular cases though individuals might not have undue privileges. In the case of religious and educational trusts, however, the present facilities should continue to be available. Suspensions and remissions will have to be necessary according as the tenants are seriously in difficulty or there is a heavy loss on account of crop damage or otherwise.

Question No. 151.—Are there any suggestions which you would make in regard to the assessment of:

- (i) agricultural land in rural areas, used for non-agricultural purposes;
- (ii) land classed as agricultural but now part of an urban area and used for non-agricultural purposes, and
- (iii) land classed as non-agricultural, whether in rural areas or in urban areas, and used for non-agricultural purposes?

Agricultural land in rural areas used for non-agricultural purposes need not be distinguished. But the

land classed as agricultural and presently forming part of the urban areas and used for non-agricultural purposes should attract penal levy if it so happens that agricultural production suffers thereby and other advantages accruing are not exactly offsetting. On land classed as non-agricultural in urban areas used for non-agricultural purposes special levies must be charged appropriately though local bodies will be operating in this sphere. It is necessary, however, to exempt from any special levies establishment of schools, hospitals or similar institutions of public interest. The question has not much significance in the rural side except where marketing centres or others having a utilitarian value, deriving an income. In these cases a licence fee or a similar levy may be imposed. The local bodies will again come in.

Question No. 152.—Is the administrative system, in so far as it is concerned with the collection of land revenue, adequate? Is there a tendency to enlarge the functions of the revenue staff, especially at the village level so as to include "Development" or "extension" duties? If so, how far is such tendency likely to affect the efficiency of revenue collection and administration?

The administrative system relating to the collection of land revenue in the ryotwari areas in Madras is efficient enough though the village Munsif, Karnam and others have been obliged to undertake functions other than revenue collection. These cannot be said to be exactly interfering with their duties though it gives some powers which are dangerous in certain respects. Besides, where certification is involved there is some discretion which results in losses of revenue.

Question No. 153.—Is there a tendency to delegate the functions of the State Government in respect of land revenue to local bodies?

In what areas, to what extent and subject to what conditions has the delegation taken place, and what lessons, if any, may be drawn from the experience hitherto gained? Do you consider such delegation fiscally and administratively desirable? Would it improve the position if the revenue collected under it was earmarked for specific local purposes?

This tendency is not in evidence to any great extent. There are no cases in Madras or West Bengal. If there were actual delegation the tendency should be deprecated as it will lead to administrative difficulties. The collection of land revenue should be on a State basis and it would not improve the revenue position even if it is collected and earmarked for specific local purposes. Earmarking for specific purposes is difficult in principle especially when it has to be extended from the urban to the rural areas or vice versa.

Question No. 154.—(i) What should be the basis of levy on land cess? Should it be land revenue or annual value?

(ii) Would you introduce a degree of graduation in the rates of land cess?

(iii) (a) To what extent do you consider it suitable that land cesses should be placed within the purview of local bodies?

(b) Should the cesses be earmarked for specific purposes more closely related to the rural taxpayer? If so, please give your suggestions. Alternatively, do you propose one consolidated cess for local purposes?

(iv) Are there any special problems involved in the assimilation of the rates of land cess (a) in the merged areas of Part A States and (b) in Part B States?

Cesses can be collected for local purposes. But there cannot be any degree of graduation in the rates of land cesses and they should be a percentage of land revenue and not annual value. Collection also cannot be entrusted to the local bodies as it will involve unnecessary expenditure. In view of the difficulties of the municipal bodies and precarious finances of the unions it will be helpful if a consolidated cess for local purposes can be levied and distributed by the State Governments for local purposes.

Question No. 155.—Would you recommend any of the following taxes either singly or in combination, where a major irrigation work has been constructed by the State:

- (i) a betterment levy representing a portion of the increase in the value of land;
- (ii) an irrigation rate for the water actually supplied;
- (iii) a small compulsory cess for all lands under command, whether the water is actually utilised or not;
- (iv) any other taxes, as an alternative to or in conjunction with the above?

In places where a major irrigation work has been constructed by the State, we have already indicated that betterment fees on a reasonable basis should be levied on first sale of land benefited by the construction of such major irrigation works. An irrigation rate for the water actually supplied might also be collected. There cannot, however, be compulsory cess for all lands under command as it may so happen that it will be difficult to develop the land or there might be some delay due to other causes. The cess should be payable only after a reasonable time as the land-holder concerned should be able to take advantage of the improved facilities after the new projects come into being.

Question No. 156.—What portion of the income in land value may be reasonably absorbed by the State as betterment levy?

How should it be assessed, in what instalments should it be collected and by what administrative machinery?

How would you time the recovery in relation to development, i.e., before the project comes into full operation or afterwards when substantial increment value is actually realised?

Would it be proper and practicable to impose a betterment levy on lands already benefited by an existing irrigation work?

Should the proceeds from the levy be earmarked for a specific connected purpose, e.g., contributing towards the cost of the particular irrigation projects or of other irrigation projects?

Since a betterment levy is more or less taxing of capital gains, the objective should always be to improve the condition of the masses and secure through such betterment levies some portion of the capital expenditure incurred on a particular project. The registration department in the various states should be obviously the machinery, which will enable collection of the betterment fees in conjunction with the revenue department. It should be the endeavour to collect as far as possible the proceeds on account of the betterment fees in convenient instalments especially where the land-owner is in need of the amount secured and has sold a part of his estate for securing necessary funds for development purposes. In this context, the Government could probably create the required machinery to look after their requirements besides ensuring reasonable facilities for development purposes. Also, a hold should be retained in order to be able to collect the betterment levies which are paid in instalments. Except where the Government themselves have taken care to retain possession of property and land which will get appreciated in value it will be advisable to time the recovery in relation to development after the project comes into full operation when it would be definitely known what exactly will be the minimum increment value. It may be justifiable in principle to impose a betterment levy on land which will benefit by the existing irrigation works. But in view of the fact that the new owners might not have benefited to any great extent and it would not be correct to impose a levy where none was expected, this idea need not be pursued. The proceeds from the levy of betterment fees as well as from irrigation rates for the water actually supplied should be collected towards disbursement of the interest charges, maintenance of the irrigation work, etc., while a small sinking fund can be created having regard to the life of a particular project. A cess may be levied for a definite purpose. Any surplus left over might be taken by the State where the project has been constructed out of its own resources or divided as the case may be where several States are concerned and where the Centre has played an important part.

Question No. 157.—(i) Should the irrigation rate be no more than an adequate charge for the water supplied or should it also contain an element of additional levy on the increased yield or crops? Can you indicate with reference to conditions in your State whether, and if so to what extent, there is an element of additional levy in respect of (a) old irrigation works, (b) What new irrigation works? What limits would you place on the quantum of additional levy in respect of (a) old irrigation works (b) new irrigation works?

(ii) Would you base the irrigation rate primarily on (a) area irrigated, (b) quantity of water supplied, (c) crop value, (d) any other factor?

(iii) Are you in favour of periodical revision of water rates? If so, with reference to one or more specified States, what period would you consider appropriate in conformity with economic considerations and in the light of administrative convenience?

(iv) Do you advocate concessional or incentive rates, particularly in the initial stages of development, with a view to encouraging the production of specific crops or the adoption of desired farming techniques.

(i) The irrigation rate cannot be more than an adequate charge for the water supplied. The increase

in yield or cultivation of valuable crops could be dealt with only by a revision of the land tax.

In the Madras State in the Tamraparni river system there is a water rate which contains a certain amount of loading and during the days when prices for agricultural produce were very low the land tax plus water tax worked out to 15 per cent. of the value of the net agricultural income. Conditions now, however, are different and the tax is more lightly borne.

In respect of old irrigation works, except where the schemes concerned are not paying their way or there is in the near future need for replacement or reconstruction, as for instance in the Godavari and Kistna systems, there is no case for a special levy. In the case of the two systems mentioned above, as considerable benefit has already been derived by the affected territories, a special surcharge can be levied the proceeds of which will be earmarked for utilisation on the projects when necessary. The special surcharge cannot, however, be more than 10 per cent. of a revised rate. In respect of new irrigation works the water rate has presented some difficulties, as for instance in D.V.C. area and the special circumstances of the case will have to be studied. The older projects did not present difficulty as they were mainly irrigational and where they are serving many purposes they are paying their way.

The bigger multi-purpose projects fulfil many functions and it is difficult to cost clearly. The special problems of each case will have to be thoroughly examined. Apart from some aspects of the policy that can be followed, as indicated above, definite formulae cannot be laid down.

(ii) The irrigation rate has relation to the land-tax levied, the cost of the project in question and the benefit derived by the area concerned.

(iii) If the water rates have been fixed initially at a fair level it may not be necessary to revise these rates periodically. It may, however, be so arranged that initially the rates are kept lower in order to encourage cultivation and stepped up later. This can be done within a period of five years. It may, however, be necessary for purposes of revenue or otherwise, to revise land taxes.

(iv) The answer to this question has been given partly in sub-section (iii) above and in question 158. Answers to questions 155 and 157 are also applicable.

Question No. 158.—How would you fix the compulsory irrigation cess? Would you make it a small fee relatable to the annual cost of maintenance of the work?

The compulsory irrigation cess should be related to the annual maintenance charges of the irrigation work, if the water rate has been properly calculated.

Question No. 159.—If the items mentioned above—betterment levy, irrigation rate and irrigation cess—were discussed in connection with a minor irrigation work, or a tube well scheme, to what extent would your replies have to be modified?

In respect of a minor irrigation or a tube well scheme no clear-cut procedure can be indicated though it must be recognised that the benefits are more localised and derived by fewer people. In these cases contribution towards cost or otherwise can be secured. The land tax also can be raised.

Question No. 160.—In what circumstances would a consolidated rate of land revenue—where the assessment includes an element of water rate—be preferable to a scheme of separate irrigation rates and cesses?

A consolidated land-tax will be helpful only in those cases where no special benefits have been derived by irrigation facilities or, otherwise. If, however, as it might happen in East Punjab following the complete functioning of the Bhakra-Nangal Project large blocks of land can be brought under cultivation, a consolidated rate can be levied. But then the rate itself would have to be fixed after taking the various aspects into consideration and the relations between the Centre and the States. The ryot may be changed a consolidated rate but, there will have to be a proper split after collection.

Question No. 161.—What is the scope for the imposition of a surcharge on irrigation rate based on:

(i) crop values;

(ii) sizes of holdings, etc., for the purpose of financing projects of a local character?

It would be hard to realise the funds required except over a very long period. Besides, apart from the adverse effects of a multiplicity of cesses and taxes, the more appropriate procedure would be to ask the local population to contribute towards capital expenditure in the shape of loans. The temptation to find capital expenditure from tax should not be allowed free play.

YIELD OF LAND REVENUE*

(In thousands of Rs.)

State	1933-34	1938-39	1946-47	1948-49	1950-51	1952-53
Madras	4,51,00	5,13,37	5,48,00	4,98,00	6,94,00	7,39,00
Bombay	3,85,00	3,54,62	3,66,00	3,73,00	6,31,00	6,26,00
Bengal (a)	3,21,00	3,24,10	4,04,00	1,92,00	2,13,00	2,10,00
U. P.	5,58,00	5,81,68	6,82,00	6,76,00	7,72,00	13,73,00
Punjab (a)	2,50,00	2,63,53	3,73,00	1,37,00	1,84,00	2,02,00
Bihar	1,77,00	1,31,52	1,39,00	1,40,00	1,59,00	3,60,00
C. P. and Berar	2,24,00	2,12,08	2,58,00	3,43,00	3,75,00	5,04,00
Assam (a)	1,11,00	1,12,64	1,79,00	1,68,00	1,90,00	1,72,00
Orissa . . . . .	..	45,96	51,00	61,00	1,03,00	1,14,00

* Excluding the amounts credited to irrigation.

(a) Figures for 1933-34, 1938-39 and 1946-47 relate to the undivided provinces.

SHOWING CULTIVATED AREA AND IRRIGATED AREA IN INDIA 1936-37 TO 1948-49.

(In '000 acres)

State	1936-37		1940-41		1946-47		1948-49	
	Cultivated	Irrigated	Cultivated	Irrigated	Cultivated	Irrigated	Cultivated	Irrigated
Madras	36,597	8,742	37,364	9,266	36,440	9,737	35,796	9,815
Bombay	29,171	11,106	29,798	1,138	29,373	1,219	34,473	1,571
Bengal (a)	29,403	1,871	30,032	1,798	12,701	1,840	12,978	1,909
U. P.	45,114	10,198	44,265	11,634	46,298	11,574	49,209	11,205
Punjab (a)	32,661	15,605	32,802	16,898	14,233	5,171	13,337	6,410
Bihar	24,487	4,319	22,686	5,243	23,109	5,320	22,607	4,879
Orissa	7,038	1,355	6,855	1,405	7,563	1,691	7,451	1,684
Madhya Pradesh	27,551	1,049	26,884	1,786	27,080	1,654	32,035	1,735
Assam (a)	7,398	655	7,675	965	5,975	1,124	6,191	1,145

(a) Figures for 1936-37 and 1940-41 are for the undivided provinces.

PART V.—OTHER TAXES (CENTRAL AND STATE).

Stamp Duties and Court Fees.

Question No. 162.—Under the Constitution—

(1) the Union is empowered to fix the rates of stamp duties in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts, and

(2) the States are empowered to fix the rates of all other stamp duties.

As regards both (1) and (2), have you any suggestions to make for the levy of a stamp duty where it is not already levied, or for an increase or decrease of the present rates where a stamp duty already exists? Please give reasons for your suggestions. Are there any general principles which you would propose for adoption in regard to the fixation of rates of stamp duties?

As regards (2), since the rates vary from State to State, what degree of uniformity do you consider desirable and feasible, and how do you propose to achieve it?

If possible, please estimate the net effect of your proposals on the revenues of States.

The rates of stamp duty should be reasonable and as far as possible uniform. No duties should be levied on cheques while the rates applicable on bills of lading in different ports should be uniform. The changes in stamp duties as between one State and another in regard to transfer of stocks and shares have led to the possession of shares on blank transfers unless dividend payments were attractive and difficult to get. A reduction in the rate will result in a larger number of registered transfers and hence larger revenues. The difference in the levy of stamp duties in the various States has also led to other difficulties, for instance, in respect of validity of instrument and documents. These differences should be removed.

Question No. 163.—Certain States (e.g., Bombay) levy stamp duties on transactions in forward markets. What is your view regarding the complaint that these duties have tended to affect the business in these markets, particularly that of the middle class traders? If you consider that the levy of stamp duty on transactions in these markets is a suitable and potentially important means of securing revenue, what administrative and other measures would you suggest for the efficient collection of such duties? Alternatively, in place of stamp duties, would you suggest some other form of taxation of transactions in stock exchanges and futures markets? If so, please elaborate your suggestion.

It is no exaggeration to say that stamp duties on transactions in forward markets are against the interests of trade. We do not agree that this is an appropriate means of securing revenue. We have already indicated in answer to Question that taxation of stock exchange transactions or futures business will be restrictive and should not be imposed.

Question No. 164.—In this country, the stamp duty is ordinarily a tax on documents which constitute evidence of legal rights. There are, however, certain taxes, such as the entertainments tax, which are sometimes collected in the form of stamps, and suggestions have been made that this system may be appropriately extended to the collection of taxes on the sale of goods or on other transactions. Do you agree with this view? If so, to what taxes would you extend the scheme?

We are not in favour of collecting certain taxes on the sale of goods in the form of stamps. This type of taxation is bound to be costly and cumbersome, easy to evade and difficult to collect. In regard to the entertainment tax the procedure as applied has no objection though the deposit system is operating satisfactorily. The stamp system can be extended as well as to the betting tax though here also collection might be made easier through organised agencies.

Question No. 165.—What are the more common methods of evasion or avoidance of payment of stamp duty? What means of prevention would you suggest?

There are many ingenious ways of avoiding the payment of stamp duty. One way of preventing them is, of course, to make the rates as reasonably low as possible so that there will be less temptation to avoid payment.

Question No. 166.—The rates of court fees differ from State to State. To what extent do you consider uniformity in the rates desirable and feasible?

Question No. 167.—Have you any suggestions to make regarding the schedules to the Indian Court Fees Act and the rates of levy thereunder?

Some manner of uniformity is desirable in this respect. The Central Government might place a ceiling with regard to the fees to be charged within which the States should fix their rates.

Taxes on Motor and other Vehicles.

Question No. 168.—Taking into account (a) the several taxes, Central, State and Local, which affect motor transport directly and business, trade, etc., indirectly, (b) the variation in some of these taxes from region to region and between different categories of vehicles, and (c) the relative financial needs of the different taxing authorities, both generally and, in particular, for the maintenance, improvement and extension of roads, what changes, if any, would you introduce in the present system of motor vehicles taxation? What degree of uniformity do your suggestions involve? Instead of several taxes by different authorities, a consolidated tax has been suggested: do you consider this feasible? How would you apportion the proceeds among the different authorities concerned?

Question No. 169.—To what extent and in what manner, in your view, should the proceeds from motor vehicles taxation be earmarked for road maintenance and development?

Question No. 170.—Have you any specific comments to make on the main recommendations of the Motor Vehicles Taxation Enquiry Committee, 1950?

Question No. 171.—Have you any suggestion to make regarding the extension of taxation to, or increase of present taxation on, users of roads other than motor vehicles? How would you classify the users, what rates would you suggest and who, in your view, should be the taxing authorities? How would you dispose of the proceeds?

168, 169, 170 and 171.

Taxation of motor vehicles in India is not only one of the heaviest in the World but also highly complicated. There are too many taxing authorities and there is little of proper co-ordination. One looks in vain for any rational principle of taxation of road transport. The result is that the development of both the automobile industry and that of road transport is severely retarded. There is no doubt that a single consolidated tax will be highly helpful. The Motor vehicles Taxation Committee had suggested that "the fuel tax is the best form of road user tax having regard to the fact that fuel consumption is a definite measure of the use made by vehicles of the roads and the tax is easily collected at negligible cost".

It will be helpful, therefore, if in place of the existing welter of taxes we have a single final tax, administered by the Centre, from whose proceeds a portion may be appropriated to the general revenues as well as for road development by the Centre and the balance is distributed among the States on the basis of the quantity of fuel sold in each State.

A good portion of the proceeds from motor vehicles taxation should as far as possible be used only for road development. It is difficult to state precisely how much should be earmarked in view of the fact that our roads are in bad conditions except for the trunk roads. Till recently, the Governments have been diverting the proceeds from this source to general purposes. The recommendations of the Motor Vehicles Taxation Committee are on the whole satisfactory. Even in the advanced countries nearly 50 per cent. of the proceeds of motor vehicles and allied taxes are being utilised on road development. It may so happen that with improved communication facilities and lower taxes the aggregate revenue will increase over a period.

The taxation of vehicles other than automobiles should bring in substantial revenue. Because country carts and other animal driven vehicles cause greater damage to roads some levy should be made. It is difficult, however, to impose a tax exceeding Rs. 60 per year irrespective of the fact that the carts are plying in the rural or urban areas.

Entertainments Tax.

Question No. 172.—This tax is usually levied on tickets of admission to entertainments or amusements, of which the cinema is by far the most important. In this regard, the Cinematograph Industry Enquiry Committee considered the incidence of the tax on the industry too heavy. Do you agree with this view, and in particular, do you consider that the rates have reached the point of diminishing returns?

The Committee also suggested uniformity in the rates of duty which differ widely from State to State. Do you agree with this view? If so, how should it be achieved?

How far would you apply graduation in the rates of entertainments tax?

What modification in the system of levy would you suggest?

Question No. 173.—What principles would you adopt in regard to exemptions? Should the criterion be:

- (i) character of the entertainment (e.g., educational film);
- (ii) nature of object to which net receipts are applied (e.g., charity show);
- (iii) class of persons admitted to entertainment (e.g., lowest class of ticket);
- (iv) any other factor?

Question No. 174.—How important is evasion of the entertainments tax and what methods of evasion are practised? What steps would you take to minimise evasion? Should there be a restriction on the number of proportion of complimentary tickets issued? Should collection be more generally by stamps?

Question No. 175.—Would you suggest the extension of the scope of application of the tax to any other organized and conveniently taxable forms of entertainment not taxed at present? Would you recommend the exclusion from the scope of the tax of any kind of entertainment which is taxed at present?

172, 173, 174 and 175.

The entertainment tax is relied upon as an important source of revenue and the increases in the rates of tax have not a regressive effect. The rates have not yet reached the point of diminishing returns though it may not be possible to experiment further in other areas. In big industrial cities like Bombay and Calcutta even with an increase the revenue has not been affected. Recently, there have been reports about a decline in attendance at Cinema houses. Further changes should, therefore, be carefully effected.

There is no need for uniformity. There is no harm if the rates differ widely between States. Nor do we favour any graduation.

Exemption may be given in the case of genuine educational, religious or other meritorious causes.

It is difficult to say whether there is any widespread evasion of the entertainments tax.

No hard and fast rules could be laid down regarding the issue of complimentary tickets. But care must be taken to see that payment of tax is not evaded in this manner. In West Bengal entertainment tax is already levied on complimentary tickets.

We feel that the entertainment tax need not be extended to other forms of entertainment.

Tax on the Consumption or Sale of Electricity.

Question No. 176.—A tax on the consumption or sale of electricity is levied in several States in India. Do you consider that this is a suitable tax and may be adopted by other States? Would you restrict it to consumers of energy for domestic purposes or would you extend it to sales for industrial uses also?

A tax on the consumption or sale of electricity for domestic purposes may be adopted in those States where it is not in existence. We would not, however, advocate to extend its application to sales for industrial uses as taxation of electricity for industrial consumption is tantamount to taxation of industrial raw material.

Question No. 177.—In respect of domestic purposes—

- (a) Should a distinction be drawn between the electrical energy consumed for lights and fans and the energy consumed for other domestic purposes (fridges, heaters, radios, etc.)? On what principles would you determine the rates of duty?

- (b) what exemptions would you suggest and on what basis? Would you apply a lower rate of duty to small consumers?

We are not in favour of a distinction being drawn between electrical energy used for lights and fans and that for other purposes. Exemptions may be given in appropriate cases like hospitals, temples, charitable buildings, etc.

Question 178.—If you are in favour of a duty on energy used for industrial purposes, on what principles would you determine the rates of duty?

Question 179.—How would you modify your suggestions in reply to the foregoing questions if electrical energy—

- (i) is entirely supplied by Government undertakings in a State,
- (ii) is supplied by Government undertakings in some areas of a State and private undertakings in other areas?

178 and 179.

We have already stated that we do not favour this procedure. There is already an imperative need to bring down the costs of production as far as possible and a tax on energy used for industrial purposes will have the opposite effect. Our suggestion will hold good irrespective of the fact whether the energy is supplied by the State or private undertakings.

Question 180.—What degree of uniformity as between different States would be desirable in regard to the levy of electricity duty? How would you achieve it?

We have already stated that no duty on energy consumed for industrial purposes could be levied. There is no question, therefore, of ensuring uniformity.

Betting and Prize Competition Taxes.

Question 181.—The betting tax is confined in practice to horse racing. Have you any suggestions to make regarding the rates of betting tax, the manner of levy of the tax, and the measures which may be adopted for minimising evasion of the tax?

Question 182.—Do you consider it practicable to extend the betting tax to other forms of betting? To which and how?

181 and-182.

The betting tax has proved to be so good source of revenue in West Bengal, Bombay and Madras. The rates were, however, raised so high in West Bengal in 1947 that there was a decline in revenue. It is, therefore, necessary to fix the rates in such a way that revenue is not affected.

Question 183.—Have you any suggestions to make regarding the tax on a prize competitions, e.g., on crossword puzzles? To what extent is uniformity between States desirable in regard to rates, etc. and what steps would you take to bring about such uniformity? What suggestions can you make in regard to preventing evasion of avoidance of the tax?

A tax on prize competitions is quite justified. It is desirable to make the rates as heavy as possible since there is reason to believe that the promoters make handsome profits from this source. The Bombay example can be emulated by other States.

PART VI—LOCAL TAXATION.

Question 185.—Do you consider that the system of local taxation in India is generally satisfactory and that the need for improvement is confined to matters of relative detail?

If not, what in your view are its major defects? To what extent are they related—

- (a) to the framework—constitutional, legal, etc.—within which the system operates, or
- (b) to the actual operation of the system?

Question 186.—If the framework is defective, is any part of its inadequacy traceable to the Constitution? Please explain your point of view in some detail. In particular, would you recommend the inclusion in the State list (from which all local taxes are derived) of any taxes which are particularly suitable as items of local taxation, but which do not now figure in that List? Are some of these taxes altogether new taxes or are they included in the Union List? More specifically, have you any comment to make on the recommendation of the Local Finance Enquiry Committee that "terminal taxes on goods or passengers, carried by railway, sea or air" should be transferred from the Union List to the State List?

185 and 186.

The system of local taxation in India can hardly be considered satisfactory. Broadly speaking, its defects are two fold: first, the existing powers of taxation are inadequate for an efficient discharge of the functions of the local bodies, secondly there are some bodies who are unable or unwilling to make full use of their powers of taxation. In view of the method of administration of the local bodies there are bound to be certain inherent difficulties. But in the new order of things, the

village panchayats, municipalities and others have more important functions to perform and much could probably be done if the State Government is content with laying down policy and through a system of taxes and grants puts the finances of the local bodies in a more sound position. The provision of local amenities, improving the general health of the population, raising literacy, etc., can all be done effectively if the methods followed in the U. K. and elsewhere are studied and the advantage of their experience in certain respects is derived as far as possible.

In the U. K., local rating authorities levy rates on the occupiers of property in their area. Property has a listed rateable value which can be altered at any time if shown to be incorrect. The values of all properties are reconsidered periodically. This rateable value is assessed in more than one way, but broadly speaking it is related to the assessment of the true annual rental value of the premises. Industrial property is, however, relieved to the extent that it is only liable on one-quarter of what would be the normal rateable value, while agricultural property (except dwelling houses) is wholly exempt.

Rates are then levied as a proportion of the rateable value and the rate in the pound can and does vary between one authority and another.

About three quarters of rate revenue comes from residential property.

The local authorities receive about half their net revenue from rates (virtually the only form of local taxation) and about half in grants from the Central Government.

Grants to local authorities other than those listed under Education, Housing subsidies, Health Service, Police, Roads, etc., will amount to £170 million in 1953-54.

This situation is due mainly to the constitutional position. At present the local bodies in India do not have definite sources of income and moreover, in some States, the State Government appropriates to itself the proceeds from certain taxes which strictly speaking ought to go to the local bodies.

The remedies lie in giving larger sources of revenue by allotting a share from the net proceeds from some taxes in the State list such as taxes on buildings, taxes on the consumption or sale of electricity when they continue to be levied, etc. Moreover, where institutions do not enjoy independent powers of taxation they should be given the same subject, of course, to the overall control of the State Government. Finally where the local bodies are unwilling to make effective use of their existing powers of taxation, the State should exercise its right to encourage and the right to warn, failing which the State Government itself may levy the relevant taxes. In view of the difficulties experienced and their undefined statutes and power it is necessary to have the effects of decentralisation and centralisation at the same time.

The Local Finance Enquiry Committee has suggested that terminal taxes on goods and passengers carried by railways, sea or air should be transferred from the Union List to the State List. We are not in favour.

Question 187.—Arising from the foregoing question, what considerations would you take into account in judging the suitability of a particular tax for purposes of local taxation? In so far as a tax suitable in relation to one local body may not be suitable in relation to another, what characteristics of the local body itself, as a tax-authority, would you include among the considerations relevant for the assessment of suitability? Please relate your answer to the different categories of local bodies, viz., broadly:

I. Urban.

A. City Corporations.

B. Municipalities (including Cantonment Boards).

II. Rural.

C. Local Boards.

D. Village Panchayats.

In considering the suitability of a particular item for purposes of local taxation, we have to bear in mind the nature of the local body in question and the reasonable amount of resources it requires for discharging effectively not only its obligatory duties but also its discretionary functions. So far as Municipalities and City Corporations are concerned their needs generally are greater than that of the rural areas. At the same time the Local Boards and Village Panchayats are also in need of increasing funds because their civic backwardness is colossal which can be remedied only by the provision of more amenities.

The general principle of taxation—ability to pay equitably, certainty, convenience of collection—ought to be observed as far as possible in the case of local taxation as well. We may also add that the tax system should be so framed and administered as to create in

the minds of the people a healthy sense of civic pride and civic patriotism.

Question 188.—Assuming that the State List is, or can be made adequate, is the frame work defective in individual States in the sense that it fails, at important points, to ensure proper devolution, i.e. (in this context) proper transference of tax-power from the State List to local bodies? If so, please answer Questions 189 to 194 with reference to the actual arrangements for devolution (as they emerge from the sum-total of the relevant State laws, rules, administrative orders and administrative practices) in the particular State or States to which your comment relates.

Generally it is true that the existing arrangements for the transfer of tax power from the State list to the local bodies are not satisfactory. In the case of most local bodies, the prior sanction of the Government is necessary and there have been many instances where permission has been refused to raise taxes for no valid reason whatever. In the circumstances, there is considerable force in the suggestion that Local Bodies be given powers to raise taxes themselves subject, of course, to some upper and lower limits.

Question 189.—Is there failure to provide for the devolution of one or more suitable taxes upon an appropriate category of local bodies? If so, please give, with reference to each such category, instances of taxes which it would be particularly suitable for that category to levy, but which, for insufficient reasons, it is not empowered to levy.

Question 190.—Is there failure to prevent the devolution of unsuitable taxes? In other words, are taxes allowed to be levied which are manifestly unsuitable for levy by the particular category of local bodies? Please give instances.

189 and 190.

We have already referred to an outstanding example of a tax which is at present not levied by the proper authority. The reference is to the terminal taxes on goods and passengers, carried by railways, sea or air. These are now levied by the Centre. Yet another instance is the urban immovable property tax levied by the State Governments. This is clearly a field for the local bodies.

It should be one of the fundamental principle of taxation in Federation to carry devolution of powers as far as possible, i.e., the Centre should keep to itself only such powers as are absolutely necessary for maintaining defence and for efficient co-ordination of the activities of the various State Governments. There should be a wide degree of de-centralisation with the advantages of centralised co-ordination as stated above, not only in regard to administrative matters but in respect of financial affairs as well. But at the same time it should be said that in the name of de-centralisation local bodies should not be given the power to levy the type of taxes which they are unable to collect or administer properly.

Question 192.—Is there failure to make devolution sufficiently diversified in relation to the capacity of particular local bodies to exercise particular powers? Thus, do the legislation, regulation and administration, taken together, show inadequate appreciation of the distinction between—

- (i) categories of local bodies: a tax-power which may be wholly unsuitable for one category may be very suitable for another;
- (ii) degrees of development among local bodies of the same category: e.g., a tax-power not suitable for some village panchayats may be suitable for others.

Please give instances.

Question 193.—(a) In respect of individual taxes does the devolution take sufficient account of the extent to which power may be transferred, e.g.—

- (i) power to decide whether or not to levy the tax; or
- (ii) power to decide the rate of levy of the tax; or
- (iii) power to assess the tax; or
- (iv) power to collect the tax; or
- (v) different combinations of the above.

(b) In the same connection, is adequate use made of the different conditions which may be attached to the powers mentioned above, e.g.,—

- (i) condition making the levy of the tax compulsory at a stipulated minimum rate;
- (ii) condition that the rate of levy shall be subject to a stipulated maximum;
- (iii) condition to ensure the relative independence of the assessing agency; and
- (iv) condition that a particular standard of collection shall be maintained?

(c) With reference to particular taxes and particular categories of local bodies, please give instances, if any, illustrative of the following:—

- (i) a power is withheld altogether, though a certain degree of power with, if necessary, certain conditions, might be transferred;
- (ii) the degree of power transferred might be higher or lower; and
- (iii) the conditions attached might be more restrictive or less restrictive.

Question 194.—Is the devolution defective in that there are concurrent and overlapping powers exercisable by the State Government and the local body? Please give instances and explain the disadvantages involved in actual practice.

192, 193 and 194.

So long as local bodies do not have independent powers of taxation and so long as they have to obtain the sanction of State Governments for the levy of taxes, there can be no satisfactory arrangement for effective devolution. The procedure is bound to be dilatory and irksome to the local bodies. It is better to have a smaller but defined list of taxes which will lead to effective collection and ask the State or Central Governments to provide the necessary grants.

As already pointed out, the Constitution divides the financial powers broadly into lists—the Centre and the State and the latter are given the discretion to allot the resources to local bodies.

The absence of co-ordination is the greatest obstacle. Several instances have been recently brought out to show how the State Governments have often stood in the way of local bodies increasing their resources. For example, it is said rates of octroi are not permitted to be raised even when perfectly justifiable; that the list of goods which are exempted from these taxes, is frequently and arbitrarily increased.

In a country like India where there are over 1,000 municipalities and innumerable village panchayats, it is not possible to say with respect to individual taxes as to whether the devolution has been effective; whether the power to levy taxes has been effective; whether the power to levy taxes has been properly utilised and whether particular standards of collection are being maintained. Much, of course, depends on the way the elected bodies conduct their administration. The State Governments ought to take a sympathetic interest in the administration of local bodies and assist them actively not merely by the devolution of more powers where desirable but by giving loans on easy terms when necessary. At the same time, they should not hesitate to supersede such bodies as consistently expose themselves to extravagance and maladministration.

Question 195.—(a) Is there, in your opinion, defective co-ordination—fiscal, administrative or other—between particular local taxes and allied State or Central taxes? Please give instances and point out the nature and order of the detrimental effect, if any, on the public or on trade, industry, etc. What remedies would you suggest?

(b) Does the lack of co-ordination, in any particular instance, result in unnecessary duplication of staff or other forms of wasteful administration? Does it lead to needless harassment of the tax-payer by different tax-agencies? What remedies would you suggest?

We have partly answered this question in one of our previous paragraphs (Questions 189 and 190). We are reverting to the topic again while dealing with Question 200.

Question 196.—Apart from defects traceable to the Constitution (Question 186) or the legal and other arrangements for devolution in individual States (Questions 188 to 194) or to inadequate co-ordination between the different tax structures, Central, State and Local (Question 195), are there any other important types of defects in the framework of the system? Please give instances. What remedies would you suggest?

The defects in the existing structure, apart from those ascribable to the Constitution, may be attributed to the fact that until recently, we were having a highly centralised and unitary type of Government. Now, however, things are different and it is to be expected that, with greater initiative and enterprise, local bodies would be able to render a better account of themselves.

Question 197.—Have you any comments to make on the proportion borne by the tax-revenue of different categories of local bodies to—

- (i) non-tax revenue other than grants-in-aid, and
- (ii) grants-in-aid?

Question 198.—Do you consider that local bodies fail to make full use of the tax resources available to them? Would you agree that they should use their powers of taxation fully before receiving further

grants-in-aid as a means of adding to their resources?

So far as grants-in-aid are concerned, it may be mentioned that this procedure is important in the evolution of local self-Government in U.K., U.S.A., and elsewhere. State Governments in India should see to it that adequate grants are given to the local bodies, of course, after satisfying themselves that the body concerned is not lethargic in its financial administration and that the grants are effectively used for the purposes they are meant for.

Question 199.—If it was necessary to equip local bodies with additional resources beyond their powers of taxation, which of the following alternatives would you prefer and why:—

- (i) transfer of additional powers of taxation;
- (ii) assignment of a proportion of a tax or taxes collected by the State Government, within the area of a local body, (a) with the local body exercising no responsibility in respect of the tax or taxes, (b) with the local body exercising responsibility of different degrees (e.g., for assessment, collection, etc.) in respect of the tax or taxes;
- (iii) grants-in-aid?

Please elaborate your answer with reference to the particular taxes you have in view in regard to alternatives (i) and (ii).

We agree that local bodies should be endowed with resources beyond their powers of taxation. One of the proper ways of doing it will be to set up a convention by which the proceeds of certain taxes will be earmarked for local needs. What exactly should be the taxes to be shared in this manner is debatable. Suggestions in this respect include the sharing of the proceeds from land revenue, sales tax and taxes on motor vehicles. We are of opinion that sales-tax should be solely assigned to the State Governments. As regards land revenue and motor vehicles tax, these may be considered provided care is taken to ensure that the sharing is effected without creating complications and, in the case of the latter, without enhancing the tax on motor vehicles which in India is already one of the highest in the world.

We agree that grants-in-aid should play an active part in local finance. But it is necessary to emphasise that they should be so administered as to stimulate local initiative. Grants should be resorted to only when the Government have satisfied themselves that the municipalities or district boards concerned have been conducting their financial affairs effectively and that there is a genuine need for additional resources. The system of grants-in-aid has been sometimes abused in the past and instances are not wanting where State Governments have used it as an instrument to exercise their domination over local bodies. It is necessary therefore to lay down clearly the principles on which local institutions can expect grants for reasonable needs. The emphasis should always be on the promotion of local enthusiasm and autonomy.

Question 200.—Since (a) lands under non-agricultural use, (b) buildings and (c) income from both these are subject to taxation by:

- (1) the Union—(section 9 of the Income-tax Act)
- (2) the States—(non-agricultural assessment and, in some States, urban immovable property tax), and
- (3) Local Bodies.

It is sometimes contended that there is multiple taxation of the same source of income and that, in any case, there is need for correlating these different taxes into a more rational system. Do you agree with this view? If so, what scheme would you suggest for the purpose? Would you adopt a uniform basis of all the taxes concerned, Central State and Local? What basis would you adopt: the capital value of the property or its annual rental value?

Question 201.—If the question of valuation was confined to the levy of urban immovable property tax by States and general property tax by local bodies, what basis would you adopt: capital value or annual rental value? Do you agree with the recommendation of the Local Finance Enquiry Committee that "there should be no change from the well-tried basis of rent to the more or less uncertain basis of capital value", but that where "municipalities are actually adopting capital value as the basis and there is no complaint, that Basis may continue"?

200 and 201.

This is yet another glaring instance of defective co-ordination. The harm done by this type of multiple taxation should be remedied. We agree with the Local Finance Enquiry Committee's observation that there should be no change from the well tried basis of rent

to the more or less uncertain basis of capital value. The latter basis while it may be advantageous from the point of view of the local bodies will be difficult of application as it will introduce a speculative element and unfairness in incidence. There is an increasing tendency to charge increasingly heavy taxes and it may so happen over a period that building construction will be discouraged considerably. Revenue considerations alone should not be the criterion.

Question 202.—As regards the urban immovable property tax, the Local Finance Enquiry Committee says in effect that, even though property tax generally should be left to be exploited by local bodies, it would be both expedient and suitable for the Government (i) to levy an urban immovable property tax when a municipality fails to levy a property tax in spite of a statutory obligation to do so or (ii) to continue to levy the tax when a municipality refuses to increase its property tax to the extent the State Government is prepared to reduce its urban immovable property tax. Do you agree with this view? Have you any other comments to make on the urban immovable property tax? If you consider it a suitable form of taxation for the States, what modifications, if any, would you suggest in regard to exemptions, rates of levy, mode of assessment and procedure for collection?

We agree that the State Government should have the power to levy an urban immovable property tax when a municipality fails to do so despite a statutory obligation to that effect.

Question 203.—What principles would you recommend for adoption in regard to the general property tax? Would you exempt rental values below a particular level? How would you deal with the properties of owner-occupiers or of charitable or educational trusts or of co-operative housing societies? What remissions, if any, would you give for vacancies? So far as new buildings are concerned, would you recommend exemption for the first few years after construction, with a view to encouraging house-building?

Question 204.—Should property tax be progressive? If so, how and to what extent?

203 and 204.

In view of our economic position it is necessary to adopt the proportionate instead of the progressive principle. As Hicks says "A tax which is proportional or even moderately regressive is more appropriate for a local purpose than a progressive tax". Exemptions need not be given for rental values below a particular level. We fully agree that in the case of new buildings exemption should be given for the first few years after construction or a lower rate charged so as to provide a stimulus to house building.

Question 205.—What categories of local bodies should be empowered to levy property tax? What should be the extent of the power in each case, and what conditions if any, should be attached to the exercise of the power?

Question 206.—Have you any suggestions to make in regard to the administrative machinery and procedure for the assessment and collection of the property tax in relation to the different categories of local bodies?

205 and 206.

We believe all categories of local bodies are entitled to levy property tax. In fact, in the case of some corporations and municipalities, such levy is compulsory. We believe it is desirable to fix in the Act itself the maximum and minimum rates. We have no special comments to offer on the suitability of the administrative machinery except to emphasise the need for honest and efficient personnel.

Question 207.—In so far as certain taxes usually known as "service taxes"—e.g., water, lighting, drainage and conservancy taxes—are levied along with, and on the same basis as, the general property tax by certain local bodies, what suggestions, if any, would you make in regard to the rates of levy, collection, etc., of these taxes? Have you any comments to make regarding property and service taxes vis-a-vis port trust properties, railway properties, other properties of the Central Government and properties of State Governments?

In regard to service taxes, we would like to observe that it is one of the elementary functions of a municipality to look after efficiently such aspects of civic life as water, lighting, drainage, conservancy, etc. If the receipts from taxes levied for these particular items are not adequate, even after reasonable efforts have been made, they should be met from the general revenues. In any case, we should not accept the view that if the receipts from a particular rate fall below the amount required that service itself should be cut down.

The condition of our cities and villages is deplorable from the sanitary point of view and there is no use approaching the problem with a petty accounting mind.

There should normally be no exemption from municipal taxation for the property of port-trusts State Governments or the Central authorities.

Question 208.—Do you consider that the system of local fund cesses (viz., cesses on land revenue, collected by the revenue administration and handed over to local bodies) is satisfactory in its operation? If not, what alterations, if any, would you suggest? Please deal with local boards and village panchayats separately, and specify the individual State or States to which your reply relates. In particular:

- (i) Are minimum and/or maximum rates of levy laid down? Are they, in your opinion, either too high or too low?
- (ii) To what extent are the cesses ear-marked for different purposes (e.g., road cess, education cess, etc.)? Would you extend or curtail the system of ear-marking? Should there be a general cess in addition to ear-marked cesses? In what circumstances?
- (iii) To what extent do suspensions and remissions of land revenue affect the collection of the cesses? Have you any suggestions to make in this connection?
- (iv) Please deal with any special problems connected with local fund cesses in—
 - (a) Part B and Part C States,
 - (b) areas in which zamindars are newly abolished.

The system of local fund cesses is not wholly satisfactory. At present the main source of income for the district boards is the cess on land. This is collected by the revenue authorities as a surcharge on land revenue and after deducting the cost of collection which varied from 2 to 4 per cent. is given to the district boards. In view of the fact that the State Governments do not engage additional personnel for the collection of surcharges, the complete proceeds might be allocated to the local bodies.

In most States the maximum and minimum rates are fixed. In some States the rates are high, in some low. In West Bengal, for example, it is pointed out that though the price of paddy has greatly increased in recent years, the cess continues to be levied on the old scale.

Earmarking of cesses for particular purposes should be encouraged though where a multiplicity of purpose is involved a consolidated cess would be preferable. In West Bengal, for instance, cesses are earmarked for education and for roads and public works. Suspensions and remissions of land revenue will proportionately affect the collection of cesses but in such situations, care should be taken to see that they do not affect the revenues of the district boards since the cess forms an important source of their revenue.

As regards the former zamindari areas, we agree with the view that the responsibility for the payment of cess should be clearly fixed on the Government or on the tenant who holds directly from the Government.

Question 209.—Please state your views on the relative merits of octroi and terminal tax, in one or more of the forms in which they prevail in different parts of the country from the stand-point of—

- (i) the local body concerned, e.g., revenue derived and, in comparison with it, cost of collection, size and complexity of administration, scope for evasion, etc.,
- (ii) the person who pays the tax, certainty as to amount payable and convenience of collection; and
- (iii) the trade, the consumer, etc., incidence and effects of incidence, in so far as these can be broadly assessed.

Are octroi and terminal tax mutually exclusive system, or would it be permissible and desirable, in certain circumstances, to combine the two systems?

On an examination of the relative merits of (a) octroi (b) terminal tax and (c) any desirable form of combination of the two, which particular alternative would you recommend for general adoption by local bodies? Do any constitutional or legal difficulties stand in the way of implementing your suggestions?

Question 210.—Does your examination lead to the conclusion that both octroi and terminal taxes are unsuitable as forms of local taxation and should, therefore, be abolished? If so, what substitutes would you recommend? Do you consider the suggestion that local bodies should be allowed to levy surcharges on sales tax feasible and desirable?

Question 211.—If your suggestions involve certain modifications in the prevailing forms of octroi or

terminal tax, what are the changes you would recommend?

209, 210 and 211.

These three questions can be conveniently clubbed together. We have referred already to the need to allot the proceeds of terminal taxes, now collected by and distributed by the Centre, to the local bodies. As regards octroi, it is generally admitted that it is a cumbersome form of taxation harmful to trade, industry and the public. But since its abolition may upset the resources of local bodies it is necessary to provide an alternative source of income for them. We would not suggest that Government might share a portion of the proceeds from sales taxes with those local bodies who are prepared to forego the abnoxious octroi. The question, however, may be considered as to whether a surcharge can be levied on the existing sales tax to be passed on to the local bodies concerned.

Question 213.—Should the basis of assessment for octroi be ad valorem or by weight, etc.? How would you provide against procedural delays and difficulties?

So long as octroi is not avoidable it is perhaps better to levy it on ad valorem basis though the weight basis may also be necessary in some cases.

Question 214.—Would an extension of the nationalisation of motor transport make it possible to adopt a simpler and more effective system of terminal taxes on goods transported by road?

We are opposed to any extension of the nationalisation of transport.

Question 215.—Have you any suggestions to make in regard to the better correlation of octroi or terminal tax with allied forms of State and Central taxation such as sales tax, excises and customs?

Question 216.—Taxation on goods carried by road is only one of the items covered by entry No. 56 of the State List, viz., "taxes on goods and passengers carried by road or on inland waterways". Have you any comments or suggestions to make in regard to the utilisation of this entry for purposes of local and/or State taxation?

215 and 216.

Part of this question has been answered already. We would suggest that proceeds from taxes levied on goods and passengers carried by road or on inland waterways should as far as possible be utilised to develop the condition of roads and waterways. If the municipalities and district boards are unable to find sufficient funds for this purpose, then there is no reason why the State Governments cannot assist them out of the proceeds from this type of taxation.

Question 217.—Should the "pilgrim tax" levied by certain local bodies be more widely adopted? Do you consider that a suitable form of taxation on the floating population in the bigger cities can be devised?

The question of adopting pilgrim tax may be necessary in view of the extra expenditure incurred to provide amenities for the pilgrims.

As regards the floating population it seems better to allow them to float rather than sink by imposing taxes on them. The Local Finance Enquiry Committee's recommendation to municipalities to levy tax on visitors in the form of a surcharge on the hotel bill seems rather hard.

Question 218.—What are your views regarding the desirability and feasibility of a "poll tax" as a form of local and/or State taxation?

The poll tax has become (or is fast becoming) obsolete in advanced countries in the world. In ordinary circumstances there seems no justification for this sort of impost.

Question 219.—(a) Have you any suggestions, not already covered by your previous answers (e.g., on motor vehicles taxation), to make regarding the levy of taxes on vehicles, animals and boats for purposes of local and/or State taxation?

(b) Do you consider tolls a suitable form of local and/or State taxation? In what circumstances?

(a) We wish to emphasise that taxes on vehicles, animals and boats should be light in view of the urgent need for the development of communications and incidentally for providing more employment. Our roads and waterways are much neglected and obviously one of the effective means of stimulating activity in these fronts is to lighten the load of taxation.

(b) The Committee are generally not in favour of tolls being levied save in very exceptional cases where the building of costly bridges or otherwise are involved and it is found necessary to recoup some part of the capital expenditure over a period.

Question 220.—The Local Finance Enquiry Committee recommends that the limit of Rs. 250 placed on profession tax by the Constitution should be raised to Rs. 1,000. Do you agree? Would you

recommend the wider adoption of profession tax by local bodies and/or State Governments? Which categories of local bodies may suitably levy it and with what safeguards? Should the levy be compulsory in certain cases, and if so, at what minimum level? What modifications, if any, would you suggest in the prevailing forms of levy of this tax? What steps would you take for its better correlation with income-tax, from the point of view of incidence or for purposes of administration, etc.?

There appears to be considerable force in the argument of the Local Finance Enquiry Committee that the limit of Rs. 250 placed on profession tax be raised to Rs. 1,000. Whether there is scope for wider adoption of this tax will depend on the need for additional resources and the absence of better types of taxation. We would not of course advocate compulsory levy. It is difficult to say how "better correlation" can be brought about in the administration of profession tax and the income-tax. Instead, it is rather impracticable and the experiment made by the West Bengal Government to levy a sort of poll tax on income-tax assesses proved an ignominious failure. One is a central tax and is collected by a central agency; the other is collected by the local bodies concerned. The powers regarding assessment and collection are obviously quite different from one another.

Question 221.—Certain local bodies /States levy a "theatre tax" (on each performance, e.g., each cinema show) under entry No. 33 of the State List. This is in addition to the entertainment duty levied by the State Government under entry No. 62 of the State List. What are your views on the suitability of this tax for more general adoption?

We do not think the "theatre tax" is capable of wider application as there has been recently a greater disposition on the part of the State Government to levy heavy taxes on entertainment. The receipts of the State Governments from this source are important, though it is heavily levied only in three or four States. Others may probably derive larger revenues. Instead of the local bodies levying a separate tax they must be given a share of the receipts from entertainment tax. Only the Madras Corporation seems to be in receipt of a good sum. If the State Government should evolve a suitable formula, vexatious duties could be done away with altogether.

Question 222.—Have you any suggestions to make regarding the levy of betterment taxes by different categories or local bodies (e.g., by a municipality in connection with town improvement)?

We do not think the levy of betterment taxes for town improvement purposes is justifiable. It will be difficult to determine the basis and avoid arbitrariness.

Question 223.—Have you any comments or suggestions to make on any items of local taxation not covered by the foregoing questions?

Question 224.—Have you any general suggestions to make regarding the fuller utilisation of their tax resources by different categories of local bodies?

Question 225.—Have you any general suggestions to make regarding assessment and collection of taxes by different categories of local bodies with a view to making the administration in this respect more efficient and more economical?

Question 226.—What problems, if any, not covered by the foregoing questions are special to Part B States? Please state how would you deal with them?

Question 227.—Have you any comments, not already covered by your answers, make on the recommendations of the Local Finance Enquiry Committee so far as they are relevant to local taxation?

While we have stressed the need for local bodies being given more financial resources we should also stress at the same time the need for economy and efficiency in administration. When one finds that even Central and State departments of the Government are not always very careful about the spending of public funds, it is perhaps unfair to expect better standards from local bodies. Yet if democracy is to develop, our municipalities, district boards, and panchayats should not only learn to collect taxes efficiently but also to use the proceeds effectively. Economy, it should be remembered, is one of the most fruitful sources of revenue.

So far as Part B States are concerned they were, so to say, in political wilderness (at any rate most of them) till recently and it is possible that in many States the foundations for a healthy local self-government have to be well and truly laid. It would seem better, therefore, to proceed rather cautiously in the matter of democratising their municipalities and other local bodies. It is perhaps not advisable to give them the same financial powers as enjoyed by their counterparts in A States. A policy of "go slow" appears desirable in the early stages in the matter of devolution.

Question 228.—Should provision be made for manual labour being contributed (a) as an addi-

tional tax or (b) in payment or part-payment of an existing tax, to one or more categories of local bodies or to State Governments, in furtherance of specific local development or, generally, of the development programme of the country? What in your view, are the possibilities and implications of the suggestions?

Without introducing any element of compulsion, payment of taxes in kind may be considered and accepted whenever necessary.

Copy of letter dated 21st April 1954 from Employers' Association, Calcutta, to the Secretary, Taxation Enquiry Commission.

"The Chairman of the Commission expressed a desire, when representatives of our Association gave oral evidence on 13th March last, that concrete data might be furnished elucidating the point explained by us regarding the need for maintaining uniformity in progression, once the rate had been decided upon. It was pointed out by our President and myself that the tax curve in the super-tax bracket should more or less correspond to the straight line as drawn in the graph attached herewith.

While we stated that, in effect, the revision of rates would amount to the imposition of the maximum rate at a higher level, the exact amount of relief that would have to be given to the various income groups was not ascertainable as the rates could not be worked out immediately.

Table I attached herewith will show that there will have to be a substantial reduction in the rates, particularly in respect of the income groups between Rs. 25,000 and Rs. 1½ lakhs. Against the maximum rate, including the surcharge of 13·1 annas in the rupee, which is now attracted by incomes of Rs. 1·5 lakhs and over, there would be a rate, on the straight line basis of only 9·5 annas, on the slab between Rs. 1·5 lakhs and Rs. 2·5 lakhs. The rate on incomes of Rs. 15 lakhs and over will be 15 annas in the rupee against the current rate of 13·1 annas. The average rate, however, will be less, as will be evident from the figures given in Table II.

We shall be only too glad to furnish you additional particulars which you may require. Kindly acknowledge receipt of this letter and the enclosures."

TABLE I.
Slab Rates on the basis of the straight line and the rates in 1954-55.

Slabs (Rupees)		Straight line		1954-55
First	1,500	Nil	Nil	Nil
1,500 —	5,000	9·45 pies	9·45 pies	9·45 pies
5,000 —	10,000	1·84 as.	1·84 as.	1·84 as.
10,000 —	15,000	3·15 as.	3·15 as.	3·15 as.
15,000 —	25,000	4·20 as.	4·20 as.	4·20 as.
25,000 —	32,000	4·75 as.	4·75 as.	7·35 as.
32,000 —	40,000	5·75 as.	5·75 as.	7·35 as.
40,000 —	50,000	5·75 as.	5·75 as.	8·40 as.
50,000 —	55,000	6·75 as.	6·75 as.	8·40 as.
55,000 —	70,000	6·75 as.	6·75 as.	10·50 as.
70,000 —	75,000	6·75 as.	6·75 as.	11·55 as.
75,000 —	85,000	7·50 as.	7·50 as.	11·55 as.
85,000 —	1,00,000	7·50 as.	7·50 as.	12·07 as.
1,00,000 —	1,50,000	8·50 as.	8·50 as.	12·6 as.
1,50,000 —	2,50,000	9·50 as.	9·50 as.	13·1 as.
2,50,000 —	3,50,000	10·50 as.	10·50 as.	13·1 as.
3,50,000 —	5,00,000	11·50 as.	11·50 as.	13·1 as.
5,00,000 —	7,50,000	12·50 as.	12·50 as.	13·1 as.
7,50,000 —	10,00,000	13·50 as.	13·50 as.	13·1 as.
10,00,000 —	15,00,000	14·25 as.	14·25 as.	13·1 as.
15,00,000 and over		15·00 as.*	15·00 as.*	13·1 as.

* Actually 14·8 as. rounded off to 15·0 as. for administrative convenience.

TABLE II.
Showing the actual taxes payable and the percentages of tax burden on typical incomes (all earned) in 1954-55 and on the basis of the straight line.

Income (Rs.)	Tax amount		Tax percentages	
	Straight line	1954-55	Straight line	1954-55
5,000	117	117	2·3	2·3
10,000	517	517	5·2	5·2
15,000	1,140	1,140	7·6	7·6
25,000	3,305	3,305	13·2	13·2
50,000	11,900	15,440	23·8	30·9
1,00,000	34,200	50,064	34·2	50·1
1,50,000	60,700	89,439	40·0	59·6
2,50,000	1,20,000	1,71,470	48·0	68·6
3,50,000	1,85,700	2,53,501	53·1	72·4
5,00,000	2,95,000	3,76,548	59·0	75·3
10,00,000	6,98,000	7,86,704	69·8	78·7
15,00,000	11,43,000	11,96,860	76·2	79·8
20,00,000	16,07,000	16,07,167	80·3	80·3

DELHI

Delhi School of Economics.

A MEMORANDUM SUBMITTED TO THE TAXATION ENQUIRY COMMISSION

This memorandum deals with only one of the issues raised in the Questionnaire, namely the role of taxation in economic development. The need for rapid development is now a basic premise in the formulation of economic policy, and obviously proposals made in the field of taxation have, therefore, to be related to it; we assume that other considerations would be generally regarded as secondary. The thesis put forward in this memorandum is that not only is it necessary to relate taxation policy to the needs of development—which is obvious enough given the premise—but that it is important to define what precisely constitute the needs of development, as there can be differences of opinion on this question and the approach to taxation that one adopts now would depend on the particular view that one chooses to take.

2. In defining the needs of development, there is a distinction to be made between what is needed to initiate a process of growth and what is needed to sustain a process already initiated. Broadly speaking, a process of growth can be regarded as initiated only when the rate of capital accumulation reached is high enough to sustain *per capita* consumption standards in the community at a minimum level and yet to leave a margin of productive capacity which can be used for stepping up the rate of capital accumulation still further. Obviously this depends mainly on the consumption standards which the community can be persuaded or compelled to accept in the initial stages—the lower the consumption standards and the longer the period over which they are acceptable the quicker can a process of growth be initiated. This is largely a matter of judgment, but if we make certain assumptions regarding levels of consumption and also as to capital-output ratios, we can estimate approximately the rate of capital accumulation on the attainment of which the period of initiation can be regarded as more or less completed, and also the likely length of this period.

3. In countries starting from low levels of consumption and saving, like India, the problem of stepping up the rate of capital accumulation is undoubtedly a difficult one. It involves, in the first place, problems of organisation and technical knowledge; no less important is the fact that, in a political democracy, there are definite limits to compulsory direction of resources even for purposes of development. But while it is important not to under-estimate these difficulties, it must be recognised that there are very substantial advantages in aiming at a quick spurt in the rate of capital accumulation. A small increase in the rate of accumulation would, of course, be easier to achieve, but the investment potential it creates in the following period would also be small; in countries with growing population there is a constant tendency for increases in productivity to be absorbed by increased consumption requirements, and, since the longer the period over which consumption restraints are imposed the less effective they prove, a process of development initiated by small increases in investment is in danger of failing to gather momentum and even petering out. The ability of a system to develop sufficient power within itself to continue a process of development depends to a very considerable extent on the strength of the initial stimulus.

4. One of the crucial factors in the determination of targets of investment is the attitude taken to their expected price effects. Any increase in investment, or even a change in the pattern of investment, will inevitably lead to certain changes in the structure of prices; but while the total of money incomes in the community will not be increased by more than the actual increases in productivity, as long as the level of investment is not allowed to exceed savings, and the price changes will, therefore, be contained within certain limits, the possible range of price changes becomes wider when the scale of investment is greater than is warranted by the savings of the community and hence involves the creation of credit. It follows that, though it would be wrong to pose the choice as one between price stability and inflation, there are nevertheless differences, in the degree of change in the structure of prices which may be expected in each case, for attention to be concentrated on the issue whether or not the rate of capital accumulation aimed at should be in excess of the community's propensity to save. This issue, which has come up again and again recently in connection with discussions on deficit financing and on banking policy, is likely to prove of critical importance in determining the pace of development in this country, and it is our

belief that on the attitude taken to it will depend also the taxation policy to be followed in the next few years.

5. If price stability is the major consideration (whatever is meant by it), and if in consequence there is a bias against investments financed by credit creation, the emphasis in taxation policy will have to be on increasing public savings (i.e., from revenue surpluses) but only to the extent that it does not have the effect of reducing aggregate savings and particularly private savings at certain key points. In practice, given a private sector which is expected to contribute to the total investment effort from out of its own savings, two conclusions must follow inevitably: firstly, that changes in the direction of more progressive taxation are detrimental to investment, and secondly, that considering the political and other implications of imposing more indirect taxation without corresponding increases in direct taxation, the addition that taxation can in all make to public savings is likely to be small to the point of being negligible from the point of view of development.

6. If, on the other hand, price stability is not the most important objective but rather the need to reach a given higher rate of investment, the structure of taxation as well as taxation policy will have to be guided by different considerations. For abandonment of price "stability" does not mean the abandonment of a price policy: it only means shifting from one structure of prices to another, and the rise in the general level of prices (which is likely to be inevitable due to sectional pressures) in the process of this shift must still be limited to the minimum. Since credit creation may not in all cases lead to increases in output where they are most necessary, and since there is in any case likely to be a time-lag between investment and output, there is a presumption that abnormal profits will emerge at various points in the system (partly through current incomes and partly through appreciation of capital values), and the function of the taxation system under these conditions must be to mop up as much of these profits as possible so as to neutralise their inflationary possibilities.

7. This is not a purely theoretical issue without significance to us at the present stage. According to the targets set by the Planning Commission, the rate of investment in the economy has to be stepped up from about 5 per cent. of the national income (at which level it has probably remained for a long time) to about 8 per cent. by 1955-56, but there is no clear indication as to where the resources are to come from. Foreign savings are expected to contribute, at best, not more than 1 per cent. of the national income; the estimates of neither public savings nor of corporate savings indicate that any large increase in these is expected; and since there is no suggestion of any major schemes of compulsory savings, it is obvious that even the relatively low investment targets set in the present Plan cannot be reached unless personal savings increase voluntarily (which, there is no reason to assume, will happen) or the rates of investment and saving are forced through creation of credit. If the implementation of the Plan so far has not resulted in any significant expansion of credit or in any serious pressure on prices, it is not because the normal propensities to save of the community have proved to be greater than was expected but because the rate of investment has in fact lagged far behind the targets and even this has proceeded against a background of falling effective demand due to other developments. The Plan can now be completed according to schedule only through a considerable expansion of credit, and if this is not possible for one reason or another it means that the targets in the Second Five Year Plan may have to be set even lower.

8. If a change in the structure of prices (i.e., in relative prices) is all that is needed to sustain higher rates of investment, it may be asked why it cannot be brought about through indirect taxation on commodities and services, with the proceeds of such taxation being used for financing the investment programme. The answer to this depends on whether or not the increase in taxation is regarded as a pre-condition of increased investment: if it is not, there is no disagreement with the main thesis put forward in this memorandum, but usually it is regarded as a pre-condition and, in this form, it is an unrealistic and essentially mistaken approach to the problem.

9. Indirect taxation has about the same relation to development programmes in under-developed countries as cuts in money wages have to employment programmes in more developed systems. The modern theories of

employment recognise the possibility that higher levels of employment may lead to declining real wages but nevertheless reduction in money wages is not advocated as a means of increasing employment: this is not merely a concession to the known resistance of trade unions to reduction in money wages but mainly a recognition of the fact that the contraction of effective demand may have consequences on the investment programme which may be neither necessary nor desirable.

10. It is true that the problem in an under-developed economy is not one of deficiency of demand, and to that extent the above analogy is not correct; but it has this feature in common that, as a rule, the investment programmes needed in the earlier stages of development initially require, only to a relatively small extent, the kind of resources which can be reached by measures of additional indirect taxation, and therefore, in most cases, these measures are also neither necessary nor desirable as a prerequisite. The initial spurt in capital accumulation has to come largely from the under-employed labour in the system (which can be reached by taxation, if at all, only through labour levies), and to mobilise these there is no reason why there should be cuts in consumption in advance by others; once under-employed labour is absorbed there will no doubt be some increases in consumption demand from them for certain commodities, and to the extent that the production of these does not also increase in the process, it will be necessary to reduce the demand for them elsewhere. In this discriminating paring of demand which will be necessary, measures of indirect taxation have undeniably many advantages over physical controls and unregulated price rises; but to insist on more indirect taxation as a source of finance to be tapped in advance of higher investment seems to be like placing the cart before the horse.

11. Increase in indirect taxes, no less than cuts in money wages, calls for faith on the part of those affected that, once it is accepted by them, things will begin to improve after a time lag. In both cases, things can improve only if one assumes that certain other conditions are satisfied, and, to the extent that they often are not, one suspects that the lack of this faith which is so widely evident is more soundly based than is sometimes thought. Unless the resources necessary for higher investment can be reached through measures of indirect taxation, and the amounts that can be thus secured cannot be had except through cuts in their existing use, and unless arrangements are made to use the released resources more or less simultaneously for the purpose of capital accumulation, increased levy of indirect taxation (like cuts in money wages in more developed systems) can only serve to increase under-utilisation of resources in the economy.

12. A carefully drawn investment programme must balance the pressures that must be expected to follow low rates of investment, with all that they imply in regard to employment possibilities and standards of living, against the pressures that will inevitably emerge if higher rates of capital accumulation lead to open inflation. In other words, the scale and pattern of investment have to be based in the ultimate analysis on an assessment of the consequent social gains and social pressures. But such an assessment, which cannot in the nature of things be determined by purely economic consideration, will nevertheless be influenced very considerably by the structure of taxation and, following from it, its capacity to intercept marginal increases in money incomes and increases in capital values in the process of development. From this point of view we would suggest that, for taxation to play its full part at the present stage of our development, the net should not only be cast very wide, anticipating as far as possible the points at which money incomes and expenditures are likely to increase as the process gets into

swing, but the rates of taxation should be steeply progressive. In the first place, the initiation of the process rests very largely on the contribution of labour by the mass of the people without much promise of higher real incomes for some years, and this fact must be reflected in the whole scheme of incentives underlying the structure of taxation. And secondly, since unregulated price rises are usually a very regressive form of taxation which tend to increase the share of profits in the national income, and since some price rises of this kind may be inevitable if the initial spurt in capital accumulation is large, the incidence of taxation on marginal increases in profits must be such as at least to help to preserve a constant ratio between wages and profits in the distribution of incomes.

13. In this memorandum we do not attempt to elaborate on the specific extension and modifications in the tax structure which may be called for in the light of the analysis above. Our concern is only to direct attention to the fact that the bias in the formulation of taxation proposals will depend to a considerable extent on the price assumptions that are made explicitly or implicitly. In so far as there is a volume of opinion in the country in favour of "price stability"—particularly among the middle classes—and no clear guidance has been given in this matter by the Planning Commission, this is the assumption most likely to be made in the natural course. It may be that, taking all factors into account it is still the most practical approach that can be made under the present circumstances, but, in any case, it must be a choice openly made and one taken with full awareness of its implications for development.

14. In a general way the implications are clear for taxation policy in the event of our choosing, or our being compelled to choose, a course which requires the initial spurt in capital accumulation being financed by credit creation. The structure of taxation must of course be widened as much as possible—this is something which we expect will, in any case, receive the attention of the Taxation Enquiry Commission—but it will need to be accompanied also by considerable deepening at points where it can be borne; otherwise the tax structure will not only be inadequate to meet situations of profit inflation but the changes made in it to extend its coverage will tend to have a pronounced regressive bias. For the widening and the deepening to be made to go together, we would suggest in particular examination of the possibilities of tapping the large expropriatory incomes which now accrue from agriculture (there is no reason why agricultural rent should not be treated as unearned income subject to heavier rates of taxation), imposing discriminatory license duties on all industrial and trade establishments, extending the principle of betterment levies to other forms of property, and increasing the rates of taxation on services which go with urbanisation (e.g., entertainments, hotels, advertisement, travel, etc.). Ultimately, it is inevitable that, when money incomes are expending rapidly, some portion of it, would escape taxation however widely the net is cast. In other words, there are limits to which taxation can help in the containment of inflation in a process of rapid development, and, in the last analysis, it may not be possible to avoid the choice between making institutional changes large enough to make possible a more effective control over money flows and accepting lower rates of economic development. The test of a taxation structure in the light of a development programme is, therefore, not in its ability to prevent inflationary pressures altogether but in helping to reduce them as much as possible given the institutional set up and the target rates of investment.

THE DELHI SCHOOL OF ECONOMICS,

January 7, 1954.

Council of the Institute of Chartered Accountants of India.

REPLIES TO PART II OF THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

Question 46.—We agree with the recommendations made by the Income Tax Investigation Commission in this regard and accordingly recommend the removal of the category described as "not ordinarily resident". Whatever the justification for the introduction of this category in the fiscal system in the conditions obtaining in or about the year 1940, it would appear that those conditions have ceased to exist now and there is no longer any necessity for the retention of this category. The removal of this category will not cause any hardship. The tests prescribed in Section 4A are sufficient to exclude hardship.

The definition of 'residence' should be so modified as to bring within its scope a company incorporated in the taxable territories under the Companies Act irrespective of whether the control and management of the affairs of such company is situated in the taxable territories or not.

There is another modification that is also very necessary. In the case of a company which becomes "resident" for purposes of assessment in the taxable territories by virtue of the income of such company arising outside the taxable territories exceeding the income arising in the taxable territories a provision should be made in section 24(2) to the effect that losses made by that company outside the taxable territories carried forward to a subsequent year should only be allowed to be set off against the profits arising to the company outside the taxable territories.

Question 47.—The definition of "income" in Section 2(6C) of the Indian Income Tax Act is not a comprehensive or exhaustive definition but is intended only to bring in certain types of income within the scope of taxable income which but for such inclusion in the definition may have been thought to be outside the purview of taxable income. A comprehensive definition of income, although attempted in the Income Tax system of some countries like Canada and Australia may not only be difficult to achieve but would restrict the scope of the tax rigidly to the types defined with the result that avoidance by making income partake a character which does not bring it within the letter of the law may become common. The significance of the term 'income', its scope, its nature and the forms it can take have been the subject of judicial interpretation in numerous cases, so that there does not now appear to be any ambiguity or doubt as to its real meaning. The assessee public has no misconceptions about the term. A precise definition by statutory enactment would set inflexible bounds where now there is an elasticity, which would appear to be more desirable from the point of view of the Revenue.

The definition of income, if necessary, may be suitably modified in the light of the answer given to question 48.

The position at present is that when as a result of fire or other catastrophe money is received from the insurance company as compensation for loss, the difference between the original cost and the written down value of the asset is treated as profit for purposes of assessment under Section 10(2) (vii) of the Income-tax Act. This procedure places the company at a disadvantage in that the monies saved after the payment of tax is not sufficient to meet the cost of new machinery in place of the old one. It is, therefore, suggested that in view of the prevalent high prices for machinery a concession should be given in this regard by not subjecting such profit to tax.

Question 48.—Among the receipts or gains which are not taxed at present but which may well be brought within the scope of the tax are casual income and compensation for loss of office or termination of employment. Agricultural income and the income of religious charitable institutions do not, it is considered, permit a disturbance of the *status quo*, one because of the constitutional position and the other because of the strong public sentiment attaching to the treatment, for tax purposes, of the income of such institutions.

Regarding taxing of capital gains, it is felt that it is an eminently suitable subject and the old provision Section 12B in the Income Tax Act may well be revived. It may be argued that now that it is certain that an Estate Duty will be levied on property passing on a death, as such gains will be included in the estate and as the estate will come in for duty at the death, there is no need for the capital gains tax being interposed.

It may be that the capital gain thus brought in for capital gains tax eventually finds its way into his estate and comes in for charge for estate duty at his death it may also be that it is disposed of *inter vivos*. In any

moment it arises. The rates of taxation in the case of capital gains should be very much lower than income tax rates.

In the case of casual income, there does not appear to be any valid reason for its exclusion from the scope of taxable income. There is, not infrequently, a windfall element in such income which makes it an appropriate subject of taxation. But it is felt that it may be unfair to subject casual gains to the full rates of taxation for such receipts in many instances are purely fortuitous. It is, therefore, suggested that casual income may be subjected to capital gains taxation.

The present treatment given to compensation for loss of office or employment as a capital receipt has been taken considerable advantage of for purposes of tax avoidance. Besides treating what in reality is an income receipt as though it were a capital receipt by the complexion given to it, takes diverse forms. Types of tax avoidance and the corrective action taken in the United Kingdom may well provide a lesson to us.

The following extract from the speech of the Chancellor of Exchequer when presenting the Budget for the year 1950-51 may be of interest: "Two years ago I referred in my budget speech to the growing avoidance of tax by means of arrangements known as restrictive covenants among others. The form taken by these is that a high executive.....undertakes not to set up in competition with the concern he serves or to serve its competitors. In return the concern gives him a large sum of money or block of shares which as the law stands is not liable to tax. I gave a warning in 1948 that I should not hesitate to introduce retrospective legislation to tax such payments if it became necessary. Since then glaring instances of such payments have been widely advertised and I am certain that the public and particularly those employed in the businesses concerned do not think it right that a particular individual should by such a device be able to evade paying his proper share of taxation. The payment of such sums is too entirely contrary to the spirit of the policy of the White Paper on personal incomes, costs and prices and can only help to break down the otherwise good record of voluntary restraint that has so far been shown in these matters. I propose, therefore, that these benefits shall be made chargeable to surtax and that the charge shall be retrospective to the year 1949-50 so that payment will have to be made next January on such benefits. In the case of the larger sums this means that over 95 per cent. of them will be payable as tax". The actual provision suggested to meet was in these terms:

That (a) where an individual who holds or has held or is about to hold an office or employment gives an undertaking whether absolute or qualified and whether legally valid or not, the tenor or effect of which is to restrict him as to his conduct or activities and any sum is paid or valuable consideration given to him or to any other person in respect of the giving or total or partial fulfilment of that undertaking such additional surtax shall be charged in respect of the income of that individual as may be determined by any Act giving effect to this resolution;

(b) this resolution shall be retrospective but tax shall not be charged by virtue thereof for any year before 1949-50.

Effective measures may, therefore, be taken under the Income Tax Act to prevent the giving to what virtually are revenue receipts the complexion of a capital receipt with a view to avoiding income tax thereby.

Any compensation received in restraint of trade or cessation of trade or business should likewise be brought within the scope of income taxation.

Question 49.—The present position of taxation is that a resident in India has to pay tax on the income that accrues to him in India, on the income that accrues to him outside India and on the remittance into India out of the profits which had accrued to him within the taxable territories before the beginning of the year and after the 1st April 1933. In the case of a non-resident, it is limited to the assessment of the profit which accrues to him in the taxable territories in the year under consideration. The concession granted to a person not ordinarily resident in the taxable territories is only this that the profits or gains which accrue to him within the taxable territories are not considered for purposes of assessment unless the profits arise from a business controlled within the taxable territories.

The question whether in the case of a resident it is proper to bring within the assessment the profits which

sideration before the Royal Commission on the Taxation of Profits in the United Kingdom. In the report the Commission has presented on this subject, the learned Commissioners relying upon the findings of the Royal Commission on Income-tax in 1920 held that the non-taxation of foreign profits of a resident would virtually amount to a premium on the export of capital and that there was no case whatsoever for exempting such profits from taxation. To quote the words of the Royal Commission of 1920 "In view of the present demand for capital to develop home industries, should we be justified in recommending differential tariff which will be more and more favourable to the British resident as we employ more and more of the capital abroad? Presumably capital is attracted to foreign countries in view of the higher taxation in this country. Could we say that two traders residing here earn profits one from trading in foreign countries and the other from trading within U. K. and pay unequal amounts of tax? Moreover we should be reluctant in our present national circumstances to suggest any measure that could possibly be interpreted as a suggestion that a bonus should be paid on the export of capital". These words exactly represent the present position in this regard in India. There is no case whatever for exempting from taxation foreign profits in the case of Indian residents. Now there is the other question whether Indian business men abroad who for purposes of taxation have been non-residents should be given concession in the matter of accumulated savings being brought to this country. If such accumulated savings are remitted to India by Indian business men during the period of their non-residence such remittances are exempt from taxation. The position, however, changes immediately they establish their residence in this country. Recently the Government has given concessions exempting from taxation foreign profits which are remitted to India by such non-resident persons in the first two years of their becoming resident in India. This apparently was given on account of the representations made that due to currency or exchange restrictions it was not possible for them to repatriate the funds all at once. This concession may be continued and in cases where there are currency or exchange restrictions the period may be extended. This has to be done by reference to the difficulties experienced in this respect in different countries.

Question 50.—The definition of the word "Dividend" as it stands at present does not provide for taxing accumulated profits of the last 6 years before the date of liquidation if such profits in the meantime had been capitalised. This appears to be a lacuna in the Act and should be remedied by a suitable amendment.

It is further suggested that distributions out of the profits made during the period of liquidation when the Liquidator carries on business for the beneficial winding up of the Company should be treated as dividends for purposes of assessment in the hands of the shareholders.

As the definition stands at present, any distribution by a company in the shape of debentures to the extent to which the company possesses accumulated profits, whether capitalised or not, is considered as a dividend. On this analogy, bonus shares to the extent that they are issued out of accumulated profits, whether capitalised or not, should come in for purposes of assessment. But in such cases, it will not be fair to subject them to income taxation. It will be equitable to consider them for purposes of capital gain taxation.

Question 51.—The interpretation placed on these sections very materially affects the interests of persons trading with but not in India, and has become an impediment to the development of trade. The Income Tax Officers are seeking to raise assessments on concerns in India as agents for non-residents where the concerns in question are buying goods in India on behalf of non-residents. Again non-residents manufacturing goods outside India, selling them outside to residents in India and then shipping the goods to India and forwarding the documents to a bank in India for the bank to collect the sale proceeds on behalf of the non-resident and deliver the documents to the buyer when payment has been received, are faced with the contention that this constitutes receipt of proceeds which includes profits in India by or on behalf of non-residents and that therefore the whole profit is assessable in India.

There are also other cases to be considered. An intending or commission agent places an order with a manufacturer abroad for supply of machinery or goods to a customer of his. The foreign manufacturer executes the order and collects the money through the bank. In such cases the commission earned by the agent is correctly subjected to tax in the country. But in such cases no attempt should be made to assess the foreign manufacturer in respect of this supply as long as the business done is on the "arms length basis."

The wholesome principle to follow in such cases is to have the distinction understood between trading with

and trading in India. If it is "with" then the transaction must be outside the purview of Indian taxation.

There is another difficulty. When the non-resident principal has a number of agents in the country, then anyone of the agents can be chosen by the Income Tax Officer as the statutory agent for purposes of assessing the Indian income of the non-resident. This places undue responsibilities on the statutory agent. The Bombay High Court has recently held that in such cases the agent is only liable in respect of the transactions that have gone through him. This principle must be accepted.

Question 52.—Reference has been made by us to the Agricultural Income-tax Acts of two States, West Bengal and Uttar Pradesh. 'Agricultural income' is defined in these two Acts in the same terms as in the Indian Income-tax Act. Under the Indian Income-tax Act 'agricultural income' is exempt from income-tax (Section 4(3) (viii)). Under the Agricultural Income-tax Acts of the States referred to, this 'agricultural income' is taxable. Thus while these Acts are mutually exclusive, it is not understood how a possible conflict between the taxing authorities can arise, assuming that in respect of Agricultural Income-tax Acts in operation in other States, the definition of 'agricultural income' is identical. To take the instances given in the question one by one, 'income from forests' if the income results from produce of a spontaneous nature on which no human effort in the way of cultivation has been expended, it will be subject to Indian Income-tax and for the same reason, that it does not arise out of any agricultural operations, it will be excluded from the scope of the agricultural income-tax Acts. If on the other hand, the income from forests arises as a result of afforestation or cultivation operations, the income will be agricultural and will be excluded from the scope of the Indian Income Tax Act by virtue of section 4(3) (viii) and being agricultural income it would be taxable under the State Acts. Then as regards dividends from agricultural companies, the Bengal Act contains elaborate provisions for computation of tax on mixed incomes, that is, incomes which partake of the nature of both agricultural and non-agricultural income. If the other State Acts contain similar provisions, there would not appear to be any occasion for overlapping of the jurisdiction of the two taxing authorities.

This point has probably been covered by the recent amendment to the provisions of Section 49B of the Income-tax Act.

Question 53.—Since "ability to pay" should be an important criterion in taxation, aggregation of agricultural and non-agricultural incomes under the Central Act is recommended. This principle has also been embodied in the Estate Duty Act where it has been provided that in fixing the rate of duty agricultural property should also be taken into account. The question whether it would be constitutionally proper to do so came up for discussion in the case of this clause. It was then pointed out that there was no constitutional impropriety in doing so.

Question 54.—We are aware that this is an entirely artificial distinction imposed by the Constitution largely as a result of historical accident and further that this kind of dichotomous division of income does not prevail in the tax systems of most countries, complicating legislative and administrative measures. This artificial distinction applies not alone to income but to taxes on capital also: for instance, under the Constitution, Parliament is competent to enact legislation by way of Estate Duty and Succession Duty only on property other than agricultural land; and it is the sphere of the States to impose these taxes on agricultural land. Even as regards capital gains the Central Government's powers would appear to extend only to capital gains in respect of property other than agricultural land. It will certainly be desirable, if it will be possible to abolish this distinction and bring both types of income under a Central Act. The abolition of this distinction will not only enable greater efficiency to be achieved but will tend to secure uniformity and avoid overlapping of jurisdiction.

Question 55.—This principle has been recognised in Section 12AA of the Income Tax Act (recently introduced). Here some relief has been given to authors and artists in respect of Income from work which has taken more than one year for completion. In the case of contracts it usually takes a number of years for the contract to be completed. But the receipt is had in one year. In such cases it is necessary that the receipt should be spread over the contract period for purposes of assessment. The Department at present is following a rule of the thumb method in assessing the film companies. The wholesome rule to follow in such cases will be to allow the assessee to value the films on the basis of cost or market value whichever is lower. There is also the example of interest on three year Cash Certificates. In a cash system this interest will fall to be considered in the year in which the cash certificate

matures for payment. But in equity this interest should be spread over the period in which it was earned and not charged in the year in which it is received.

Question 56.—Before considering the question whether any modifications are necessary in the provisions of the Act which exempt from liability to tax the income of religious and charitable trusts, an exemption which may well be described in the words of Lord Nathan's Committee on the Law and Practice relating to charitable Trusts in the United Kingdom (1952) as constituting an "immense hidden subsidy" by the revenue to voluntary effort, it may be useful to assess the place and function of these charities in public and social life. As Lord Beveridge observed; "In a totalitarian Society, all action outside the citizen's home and it may be much that goes on there is directed and controlled by the State. By contrast, vigour and abundance of voluntary action outside one's home, individually and in association with other citizens for bettering one's own life and that of one's fellows are the distinguishing marks of a free society". Voluntary Charities are encouraged in most democratic countries as "it embodies the sense of responsibility of private persons towards the welfare of their fellows and as it meets by private enterprise, a public need". It may be thought that now that we have a Welfare State as contrasted with the law and order State of earlier days there is not much room for voluntary private action in the matter of public charity. How mistaken such an impression would be will be evident from the following observations of the Committee above referred to. They say: "At no time however can we discern any antithesis between public and private welfare or the making of any fundamental distinction between their aims and functions; and to-day the public services for social welfare are carried out with the help of innumerable voluntary workers and by making use to an important extent of voluntary agencies so far from voluntary action being dried up by the extension of social services greater and greater demands are being made on it. We believe indeed that the democratic state as we know it could hardly function effectively or teach the exercise of democracy to its members without such channels for and demands upon voluntary service." In our own country, the merit and virtue attaching to charity have been impressed from time immemorial by all religions. A tax concession to charity is, therefore, undoubtedly proper and deserved.

Even so, we would like to see a distinction drawn between 'endowed' and 'non-endowed' trusts for purposes of tax treatment. By an 'endowed trust' we mean one where there is a corpus of property, it may be land or it may be a fund in diverse forms, endowed perpetually, and only the income thereof is applied to charitable purposes without affecting the corpus, a category which may be said to correspond to the type of charity contemplated in Section 4(3) (1) of the Income Tax Act. A 'non-endowed trust' in our view is one where property is in the nature of a business and the profits are devoted to a charitable purpose, a category contemplated in Section 4(3) (1a) of the Act. In the case of an 'endowed trust' conforming to the tests laid down, the income should continue to enjoy the exemption. Where however the trust is a non-endowed one, that is, where a business is carried on by a charitable institution and the profits are applied solely for the purposes of the institution, the justification for exemption from tax does not appear to us to be as strong as in the case of endowed trusts. Such non-endowed trusts may well satisfy the normal tax demands first and apply the residue for their purposes. We make this suggestion as we feel that Government's needs for funds, part of which go for equally deserving public welfare purposes are no less urgent. We do not suggest that institutions which derive their income from voluntary donations should be in any different position *vis-a-vis* income tax exemption from what they are now. Our recommendation in respect of non-endowed trusts is influenced by the fact that in recent years it has become a common practice with assesseees with large incomes to create institutions of this nature, which may not be the case if there were no advantage to be derived therefrom.

Question 57.—The exemption in respect of profits of co-operative Societies has been in force from 1925 and old practice coupled with the fact that co-operative enterprises for rehabilitating refugees and for some kinds of Community Project schemes under the Five Year Plan may be the most suitable agencies for such work would seem to justify a continuance of the concession. On the other hand some distinction may legitimately be drawn between purely mutual co-operative societies and societies which trade with the public such as marketing societies. In the case of the latter the claim for exemption would appear to be not as strong as in the case of purely mutual societies. If we take the judicial view as a guidance, the rule should be that in the case of a mutual society carrying on business with its members which does not result in a profit, the exemption should be available but that in the case of society which carries

on a trading business, whether with its own members only or with the outside public and profits are earned, there should be no exemption from tax.

The early view on the liability or non-liability to income-tax of profits arising to Co-operative Societies was laid down thus by the Madras High Court in *E and S Joint Co-operative Wholesale Society Ltd. v. Commissioner of Income-tax, Madras* (3 I. T. C. 385): "The Society cannot make taxable profits out of its own component elements, and with that starting point established, it is to my mind immaterial that the moneys which came into the hands of the 'Apex' Society are distributed in the form, in part, of a dividend to shareholders so long as these shareholders do not include any person who is not a member of the Co-operative Society."

This view was considered by the Privy Council in 1948 and set aside by them. Explaining what kinds of businesses may claim exemption from liability to income-tax under the principle laid down in the *Styles' case*, namely, that a society being a purely mutual co-operative Society making no profits was not liable to Income-tax their Lordships were of the view that "this principle cannot apply to an Association, Society or Company which grows produce on its own land, or manufactures goods in its own factories, using either its own capital or capital borrowed whether from its members or others and sells its produce or goods to its members exclusively."

The principle appears to be this, that where in a mutual society no profits are made out of transactions between the Society and the members such as mutual insurance Society there is no occasion for the tax, but where the Society is a trading concern and carries on business whether with its own members or with the outside public and out of the business it derives profits which it distributes to its members, it should not escape tax.

As section 18 of the Co-operative Societies Act 1912 provides that a society registered under the Act is a "body corporate with perpetual succession and a common seal, with power to hold property, to enter into contracts and to institute and defend suits and other legal proceedings" it would not be inappropriate if such societies are treated for tax purposes as though they were companies. In the case of Co-operative Housing Societies the principle to be followed is that the proportionate income should be assessed in the hands of the individuals and not in the hands of the Co-operative Housing Societies itself.

Question 58.—The grant of initial extra depreciation has certainly made in many of the cases the concessions to new industrial undertakings under Section 15C of the Income Tax Act somewhat infructuous. But in some of the cases the concession still would appear to be real. In these circumstances there is no harm in continuing the concessions under Section 15C for a further period of time.

Question 59.—To the extent that foreign branches of Indian banks would assist the handling of India's foreign trade to our greater advantage, and would earn invisible exports, they are entitled to some consideration but we do not see how with the present position of the law, any further modification is rendered necessary. It is true that the Import Control Advisory Committee (1950) made a suggestion in its report to Government that Government do everything they can to increase our invisible earnings of foreign exchange by encouraging the use of the services of Indian shipping, insurance and banking for the transport and finance of our foreign trade. The Export promotion Committee also made a suggestion of tax concessions being granted to offices of Indian firms opened in overseas countries. Now, Government have already explained that in respect of countries with which India has concluded Double Taxation Relief Agreements, there will be no question of double tax on the same income. Where tax is charged in a country with which India does not have a reciprocal agreement for double tax relief, Section 49D of the Income Tax Act as amended by Act 25 of 1953 provides that an assessee "shall be entitled to the deduction from the Indian Income tax..... of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country whichever is the lower". We do not think that any larger concession would, in the interests of the Revenue, be justified nor do we think that the foreign branch can legitimately expect more than the concession already available.

Question 60.—The present limits are generous and do not call for any modification.

Question 61.—On this question, we would respectfully endorse the conclusions reached by the Millard Tucker Committee which are summarised in para. 132 of their Report and which for convenience of reference are reproduced below—

(a) Whether the proposed schemes are based upon revaluation or upon the creation of a reserve for replacement, in essence they all

amount to a proposal that a business should be relieved altogether from tax on some part of its true profits, that is to say, upon its profits as computed on ordinary accountancy principles :

- (b) In fact this relief from tax would not apply to all businesses but only to those which require to replace fixed assets or stocks. To that extent, therefore, the treatment asked for would be of a preferential nature.
- (c) Where a business qualified for this preferential relief, it would do so, irrespective of the value of the business to the national economy.
- (d) None of the schemes of revalorisation or of reserves for replacement gives any relief or assistance in relation to a new business or to the expansion of an existing business.
- (e) All such schemes would involve considerable extra clerical work both on the part of the Inland Revenue and the tax payer.
- (f) Our suggestion for a system of flexible initial allowances is the only solution which meets the objections we have enumerated.

In our own country the Tariff Board has more than once declined to accept this plea that depreciation should be allowed on replacement costs instead of on actual cost as is the practice now. To quote their observations in connection with their enquiry on the Fair Retention prices of Steel produced by Tata Iron & Steel Co., Ltd., : "The representatives of the industry contended that depreciation should be calculated on the replacement value of plant and machinery. We have already dealt with this question in our reports on the prices of cotton yarn and cloth as well as of paper in which we have pointed out certain practical considerations which make it difficult for us to accept replacement cost as a basis for purposes of depreciation as also for return on fixed capital, although we recognise the vital importance of replacement. The proposal that depreciation allowance should be based on replacement costs has been found unacceptable even by professional accountants who feel that there is an element of uncertainty and arbitrariness in such a procedure. Instead they prefer the basis of historical cost both for depreciation and for valuation of stocks. They also suggest that additional sums provided for replacement should be regarded as reserves and treated as such in the accounts. Moreover there are other practical difficulties such as the possibility that costs of replacement might occasionally fall as also the fact that replacement does not always or necessarily involve the installation of an identical machine".

It is, however, to be mentioned that there is a section of accountancy thought in the world, which believes that a system could be devised, by which depreciation would be made available on the replacement cost. This particular idea has been given effect to in some of the continental countries like Belgium and France, where the system would appear to have achieved a certain measure of success. But this question was examined at length by British Institute of Chartered Accountants. They came unanimously to the conclusion that the replacement of cost basis is not practicable and so did not recommend it.

Question 62.—No change appears to be called for in the classification of assets for depreciation allowance purposes. As regards rates of depreciation, it would appear from the fact that plant and machinery have been known to be serviceable and working with reasonable efficiency for considerable periods after their supposedly normal life, as assumed for depreciation allowance purposes, the rates as a general rule would appear to be adequate taking into account the additional and initial depreciation. In the case of factory buildings, the present rate does not appear to be adequate. It may be increased to $7\frac{1}{2}$ per cent. The rate may be fixed at 5 per cent. for non-factory buildings.

The old method of computing the allowance on the 'straight line method' was given up on the advice of the Ayers Committee of 1935 and replaced by the present "written down value" method. As it is claimed that this is simpler for the Department, a disturbance of the position is not recommended, even though the displaced system is not without merit.

Question 63.—On the question whether any depletion allowance should be given to mining undertakings, we agree with the Tucker Committee's view as expressed in para. 233 of their Report "the General principle that an allowance should be given for all expenditure on assets that are used up in the carrying on of a business seems to us particularly applicable to the position of a concern which has to pay a capital sum for minerals or for the right to work minerals". Similarly prospecting expenditure incurred may be allowed over the period of the lease.

Question 64.—(i) No change, in our view, is called for in the present position.

(ii) The same answer as in (i) above except to the extent specified in answer to question No. 67 below.

Question 65.—In a period of high taxation, one of the legitimate reliefs to which an assessee is entitled is the reduction in the gap between the commercial concept of income and the income tax concept of income. Over a period of time this gap between the commercial concept and the income tax concept has become widened on account of the judicial view taken on the admissibility of certain types of expenses.

Under the present amendment to Section 10(2) (xv) any expenditure, although incurred wholly and exclusively for the purpose of the business cannot be claimed under this clause if it is covered by any of the other clauses of the sub-section, irrespective of the fact that such expenditure may be wholly laid out for the purpose of the business. These restrictions in this clause should be removed and the original position, as it stood before the amendment, restored.

In particular the following expenditure should be allowed: (1) expenditure incurred in connection with income tax appeals, particularly when the appeals are decided in favour of the assessee; (2) in the case of deferred revenue expenditure it should be allowed in instalments in three or four years; (3) where expenditure is incurred in connection with the maintenance of the reputation of a business such expenditure should be allowed, particularly when the assessee is acquitted in such cases; (4) expenditure necessarily incurred for maintaining the corporate status should also be allowed; (5) in the case of lump sums paid for acquiring leases such expenditure should be allowed over the period of the lease; (6) Patents and copyrights should be allowed over a period of years; (7) Similarly depreciation should be allowed on Roads in factory compound.

Under Section 10(2) (vii) allowance for loss is only given in the case of plant and machinery and buildings. Such concession should also be given in the case of furniture and fittings and profit if any be taxed.

Question 66.—There are difficulties in combining the income tax and super-tax into a consolidated levy. There are certain items allowed for purposes of income tax and not for super-tax. In these circumstances it will be desirable to continue the present system.

Question 67.—The exemption limits should be retained at their present levels until there is clear evidence that prices have been stabilised at lower levels when the exemption limits may be correspondingly lowered. On the other hand if the inflationary trend continues and the general index of prices rises further, it may be necessary to fix the exemption limits at higher levels.

Question 68.—(a) The distinction between earned and unearned incomes should continue to be maintained. The present reliefs are fair and equitable, but attention is invited to the fact that on the higher ranges, the margin of difference between the tax on wholly earned and on wholly unearned tends to grow narrower as the income range gets higher. By way of illustration, we set out some of the figures given in the Statement contained in the Explanatory Memorandum to the General Budget, (1952-53), page 94 :

Income.	Tax as percentage of income, where income is wholly earned.	Tax as percentage of income, if income is wholly unearned.	Difference.
12,000	5.8	9.5	3.7
13,200	6.5	10.4	3.9
14,400	7.2	11.2	4.0
15,000	7.6	11.5	3.9
16,800	8.4	13.1	3.7
24,000	12.7	17.0	4.3
25,000	13.2	17.4	4.2
48,000	30.0	32.2	2.2
55,000	32.8	34.8	2.0
60,000	35.6	37.3	1.7
70,000	39.9	41.4	1.5
90,000	49.0	50.1	1.1
1,00,000	50.1	51.1	1.1
1,50,000	59.6	60.3	0.7
2,00,000	65.2	65.7	0.5

It will be seen that in the lower ranges of income, the difference is as much as about 4 per cent. whereas in the range above Rs. 1,00,000, the disparity gets gradually blurred and is in fact even less than 1 per cent. On a higher range wholly unearned income, it would appear legitimate to expect at least a proportionately higher tax. The slab rates would appear to require a careful revision to give this result.

(b) The definition of "earned income" should be modified to bring within its scope income derived from the investments of provident fund monies received by

an employee on retirement. This of course has to be done with adequate safeguard.

(c) A slight readjustment would appear desirable and it is suggested that the earned income relief should be one-fourth or Rs. 6,000 whichever is lower. It has already been suggested that in the higher ranges the disparity between earned and unearned incomes should be steepened, not blurred as is the position now.

Question 69.—The present practice of taking the value at cost or market whichever is lower does not appear to call for any disturbance. This would appear to be the most equitable basis for valuing stocks. This matter was considered at length by the Institute of Chartered Accountants in England and Wales. After enquiry they came to the conclusion that this basis did not call for any change. This principle has also been accepted by the Millard Tucker Committee.

In valuing the stock at cost or market value whichever is lower the assessee should be allowed the right to value the stocks by what is known as "pick and choose" method. For sometime there was a dispute in regard to this method in the United Kingdom between the Revenue and the assessee. But this controversy has now been set at rest by the Department accepting the "pick and choose" method as the correct basis. The same view has also been accepted by the courts in this country. The expression "market value" is commonly interpreted as either "(1) the price at which it is estimated that the stock can be realised either in the existing condition or as incorporated in the product normally sold after allowing for all expenditure to be incurred before disposal; or (ii) the cost of replacing the stock at the accounting date."

Question 70.—The present method of assessment of Hindu Joint Families does not appear to call for any change, particularly in view of the fact that the exemption limit has been raised to Rs. 8,400 in these cases.

The present treatment given to the Hindu Undivided Families places an undue hardship on them. It is, therefore, suggested that where there are two or more adult members of the family living the income should be apportioned among them in accordance with their share in the joint family property. In calculating the tax the separate income of the individuals if any will be taken for purposes of rate. It is to be noted that in assessing the individuals in respect of their separate income the share of the individual in the Hindu joint family income will not be considered at all as at present. Though the procedure outlined above will be followed in the assessment of Hindu Undivided Families the notice of demand will be sent to the Hindu Undivided Family and the tax will be payable as one unit.

Question 71.—Where the surrender of commission is irrevocable and the managed company is a public limited company, there is no harm in exempting such surrenders from payment of tax in the hands of the Managing Agents. But in other cases it will not be advisable to exempt the surrendered commission from payment of tax in the hands of the Managing Agents unless there is adequate consideration for the surrender and unless it can be shown that the surrender is not for the purpose of avoiding or reducing the liability of the Managing Agents, or any of their partners or where the Managing Agents are a Co. any of its members.

Question 72.—The old Double Income Tax agreement with the United Kingdom involved a somewhat elaborate procedure which in practice occasioned considerable inconvenience and delay. A type of agreement which would reduce these to a minimum is that concluded between India and Pakistan in 1947, which may be taken as a model for agreements with other countries.

In other words each country should tax income which accrues or arises within its territories.

Question 73.—We do not consider that the present deductions allowed in the assessment of income from property are satisfactory, with the result that an assessee is made to pay taxes on income which is on an artificial basis and which he has never received. The allowance of one-sixth for repairs against the *bona fide* annual value of property, based on pre-war rate, has no relation to the present cost of repairs which has gone up by 300 to 400 per cent, since 1939. Similarly, outgoings in the nature of municipal taxes should be allowed in full as against the present practice of allowing only one-half of the amount of such taxes. At present, the urban immovable property tax is not allowed on the ground that it is not a tax levied by the local authority but a tax levied by the State Government and collected by the local authority on behalf of the State Government. All taxes on property with the exception of income-tax on the property incomes should be allowed as deductions in the assessment under Section 9. Such deductions are allowed in the assessment of business income under Section 10 of the Act and the effect of not allowing them under Section 9 is to assess income which has never been received by an assessee.

We, therefore, suggest that the assessment of property under Section 9 should be based on actual rent receivable less the expenditure incurred for the purpose of earning that income. The artificial basis of "*bona fide* annual value" should be deleted, except where the premises are occupied by the owner.

Another suggestion that we have to make in this connection is that where an employer provides cheap housing for his workers, he should be allowed at the time of assessment of his business not only all the outgoings in respect of such residential accommodation, but also a reasonable amount of depreciation which would enable him to replace the structure at the appropriate time.

Question 74.—A change is required in respect of provisions relating to carry forward of losses in the case of cessation of business, and we suggest that where a business is discontinued, unabsorbed losses should be allowed to be carried backwards for a period of two years and allowed to be set off against any profits made in those years.

We would further suggest that even in the case of a going concern, the loss should be allowed to be carried backwards for a period of two years immediately preceding the year of assessment, in which case, the carry forward may be restricted to four years for the balance of the losses which are not absorbed by carry back to such two immediately preceding years.

Question 75.—It is suggested that dividend income should not be subject to advance payment of tax under Section 18A except where the dividend is actually received. We suggest, therefore, that dividend income should be subjected to the same treatment as Managing Agency Commission under Section 18A (4).

If, after the service of the notice, an assessment in respect of a previous year later than that referred to in the original order of the Income Tax Officer for purposes of 18A is completed, then the assessee should have the option of paying the tax in accordance with the income computed in the later order. This should not depend upon the discretion of the Income Tax Officer as it would appear to be at present.

The section gives the assessee the right to estimate his own income for purposes of 18A. In such cases where the assessee has submitted his estimate the excess tax paid in respect of the earlier quarters should immediately be refunded. In the case of a new business the assessee should have the option of paying the 18A within three months of the close of the year. This concession should be granted to new businesses only in respect of the first year of its existence.

Question 76.—In respect of fraudulent concealment of income there is no reason why there should be a time limit at all for re-assessing escaped income. Such concealment is a crime. There should be no right of limitation in respect of any crime.

Question 77.—No comments.

Question 78.—The Income-tax Appellate Tribunal should not be given the power to enhance the assessments. It is however felt that the scope of Section 33B may be widened to enable the Commissioner of Income-tax to re-open the assessments even if the assessment has been adjudicated upon by the Appellate Assistant Commissioner. The period of limitation should be two years from the date on which the assessment was finalised.

Question 79.—The present provisions adequately meet the requirements.

Questions 80 & 81.—So long as the corporation tax is maintained on the ground that it is a tax levied on the corporate existence of a company it should be allowed as a deduction for the levy of income-tax just as excess profits tax was allowed in computing the profits for purposes of income-tax assessment.

No corporation tax need be levied in case of investment trusts which are entitled to exemption under the conditions laid down in the modification issued under section 60, sub-section (2) to encourage investment in stocks and shares.

Question 82.—The present position would appear to be satisfactory.

Question 83.—To-day when it is very difficult to raise capital it is necessary to observe a distinction between distributed and undistributed profits for tax purposes and to give a rebate on undistributed profits. We do not agree that the concession should be restricted to particular industries. It should be available to all public limited companies.

However, in the case of companies in industry to which Section 23A is applicable, a relaxation in the rule that 60 per cent. of the profits should be distributed should be made. But to ensure the interests of Revenue and to see that this device is not adopted to evade super-tax in the hands of the shareholders it should be provided that such retained profits are compulsorily

invested in Government securities until the purpose for which they are retained becomes capable of fulfilment.

Question 84.—The Corporation tax paid by a company may be deducted for purposes of arriving at profits on which income tax is payable by the company.

Question 85.—Such enterprises should pay the Government interest on capital and income tax on their profits like any non-government concern. Of the balance that remains after taxes a portion may be taken by Government to general revenues. The balance may be kept reserved in the business for expansion, for meeting future losses, if any, etc.

Question 86.—Chartered Accountants may well be made greater use of in the determination of taxable income of assessee with advantage to the Revenue in that part of the considerable time of the Income Tax Officers now taken up by the scrutiny of books and accounts would be released for other work by them. On the recommendation of the Income Tax Investigation Commission, the Income Tax Amendment Bill of 1951 proposed to provide that business assessee with an income of not less than Rs. 25,000 should submit their returns accompanied by accounts audited by a Chartered Accountant.

It must be mentioned, however, that a Chartered Accountant's certificate must in the very nature of such things be restricted to such transactions as have been brought into the books. If an item of expenditure is entered in the accounts the Chartered Accountant can ask for the production of the receipt or voucher in support of the expenditure. But here it must be understood that he cannot be made responsible in respect of the transactions which do not find a place in the books of account or transactions which do not come within his knowledge or transactions which he cannot detect in spite of the exercise of due diligence and care.

In respect of limited companies, there should be no difficulty in accepting the Chartered Accountant's report. But in respect of firms and individuals so long as the accounts are audited and the Chartered Accountant's report is in a form approved by the Central Board of Revenue, the accounts should be given the same credence as in the case of limited companies. Thus the Chartered Accountant will be undertaking a responsibility in respect of the work done by him to the extent mentioned in his Report. The form of the Report should be settled by the Central Board of Revenue in consultation with the Institute. This will, of course, not preclude the Department from applying on the accounts submitted such tests as they deem necessary for the purpose of completing the assessment.

The fees paid to a Chartered Accountant should be a matter of arrangement between him and his client and should not be restricted to a Schedule to be prescribed by Government. When an assessee selects a Chartered Accountant, he makes his choice of his own free will as to the best person, in his opinion, to handle his work, and therefore, the fees to be charged, should be left to be settled, as in the case of an attorney, between the client and the Chartered Accountant. However, for purposes of giving guidance only, a schedule of fees may be laid down in consultation with the Institute of Chartered Accountants of India.

Question 87.—While the present class of Income-Tax Practitioners may be allowed to continue as at present, no further enrolment of practitioners should be made, so that this class whose efficiency cannot be as great as that of Chartered Accountants would become gradually extinct.

Question 88.—The names of delinquent assessee should undoubtedly be published wherever the concealment is substantial and, in addition, where the concealment detected is proveable, offenders should be prosecuted and punished heavily as this is the only method of discouraging evasion.

Question 89.—In Section 4(3) there is no justification for the retention of sub-clause (vi). It should accordingly be deleted from this Section. Appropriate provisions however should be made in Section 7 or in any other relevant section to the effect that allowances of the nature contemplated by section 4(3) (vi) are allowed to the employee.

Question 90.—An obligation should be placed on the liquidator to inform the Income Tax Officer of his appointment, just as the obligation placed on him under the Indian Companies Act in Section 214. Similarly the liquidator should only be permitted to make any distribution of the Company's assets after a Clearance Certificate is obtained from the Income Tax Officer.

Question 91.—There is no case for conferring further powers on the Income Tax Officer, particularly, to search premises and seize documents and books of account.

Question 92.—The Act even now contains special provisions, for example Sections 16 and 23A. These powers should be adequate to deal with such cases.

Question 93.—From the firm to the extent of the share of the partner.

Question 94.—The present arrangements to continue.

Question 95.—In the war years, it was a common practice to quickly form private companies, do some business connected with war supplies, receive payments and then to dissolve them before the Department moved to assess them. In such cases there can be no hardship if the shareholders holding more than 20 per cent. shares of the company are held personally liable to the extent of their shares in the company.

Question 96.—Yes. It should be made recoverable.

Question 97.—The experiment, tried some time ago, of attaching Public Relations Officers in important centres to assist assessee in the making of correct returns may well be revived and reintroduced. They may give assistance in all the directions mentioned in the question. The primary consideration should be to simplify the work as much as possible for the assessee. The practice of fixing time for assessee to appear before the Income Tax Officer in vogue for the last few years appears to be working well. In other directions too, inconvenience to assessee may be saved as much as possible.

The Income Tax Officers should draw the attention of the assessee to all the reliefs to which they are entitled.

Question 98.—It is most important that facts, which form the basis of assessment and of all subsequent proceedings, should be correctly found and fully recorded. Once this is done, the assessee is bound down to the record and no quibbling about facts later can be of any avail.

Some simplification has already been done in the evolution of two forms of returns of income, one for business assessee and the other for non-business assessee.

As regards (v) the administrative control over Appellate Assistant Commissioner should be vested in the Tribunal and consequently in the Ministry of L

Question 99.—(a) One contributory factor to the delay in completing assessments is the restrictive language of Section 34 which prevents an Income Tax Officer from reopening an assessment except in certain contingencies. If he were free to reopen assessment in any contingency, there would not be much hesitation in finalising assessments. It is suggested that Section 34 be amended to give greater freedom of action to Income Tax Officers.

If the Income Tax Officer dealing with the case is transferred it has been our experience that the succeeding Income Tax Officer starts the proceedings *de novo*. As far as possible steps should be taken to ensure that the proceedings started by an Income Tax Officer should be completed by him before he makes over charge.

If the previous Income Tax Officer has not been able to complete the assessment and if it is possible for the succeeding Income Tax Officer to start proceedings at the point where the previous Income Tax Officer left it he should continue the proceedings from that stage instead of starting the proceedings *de novo*.

(b) Interest may be allowed on advance payments.

Question 100.—The history of the Excess Profits Tax or the Business Profits Tax gives an indication of the conditions in which their levy would be justified. The Excess Profits Tax has been a war-time emergency levy and the justification for it is that the State because of the urgency of mobilising resources and finding supplies has necessarily to ignore considerations of economy whereby people make profits on a scale which would not be possible under peace time competitive conditions. As the making of enormous profits are facilitated by the State, the State should be entitled to draw a part of them to itself. There are, therefore, purely emergency levies and should be resorted to only in times of emergency.

Question 101.—It is very difficult to express an opinion on the Estate Duty Bill. This has only been recently placed on the Statute Book. Some time will have to be allowed so that some experience may be gained as a result of the working of the Act.

Question 102.—The suggestion is certainly novel but is deprecated because it would mean in practice an inquisition into the histories of the properties of the deceased, after the deceased, who in many cases, would be the only person who could throw light, has departed. The measure is new and in its experimental stage it would be unwise to alienate public sympathy by such a reactionary discrimination. Further this basis does not appear to have been adopted by any of the numerous countries where estate duty is a feature of the tax system.

S. VAIDYA NATH AIYAR & CO., DELHI.

REPLIES TO THE QUESTIONNAIRE OF THE TAXATION ENQUIRY COMMISSION.

INTRODUCTORY

It is necessary to preface our answers with a short statement.

Although no specific limitations have been placed on the Commission's enquiry, such as, for instance, the bounds set by the Royal Warrants issued to the Royal Commission on Taxation of Profits and Income, in the U. K., namely, "to make recommendations consistent with maintaining the same yield of the existing duties in relation to national income", or "to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income, and in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration". We have felt it necessary in considering the questions raised in Parts II, III, V and VI to keep prominently before us that the following considerations, namely, that the Commission is desired, according to its terms of reference, to make recommendations with regard to "fresh sources of taxation" that in the short-term context of the Five Year Plan an earnest search for sinews with which in part to finance the schemes is imperative and that on a long-term view the steady growth in public expenditure which as the State's social security measures and welfare activities are expanded or accelerated must rise still higher, preclude us in a way from putting forward suggestions which however desirable they may be in the interests of tax reform, would result in an attenuation of the revenue, even though small, unless it be that there was a manifest inequity which called for rectification or unless it be that it was certain that they would conduce, psychologically or otherwise, to promote better tax payer-revenue relations, with resultant counter-vailing advantages.

Question 46.—We agree with the recommendations made by the Income Tax Investigation Commission in this regard and accordingly recommend the removal of the category described as "not ordinarily resident". Whatever the justification for the introduction of this category in the fiscal system in the conditions obtaining in or about the year 1940, it would appear that these conditions have ceased to exist now; and there is no longer any necessity for the retention of this category. The removal of this category will not cause any hardship. The tests prescribed in Section 4A are sufficient to exclude hardship.

Question 47.—The definition of "income" in Section 2(6c) of the Indian Income Tax Act is not a comprehensive or exhaustive definition but is intended only to bring in certain types of income within the scope of taxable income which but for such inclusion in the definition may have been thought to be outside the purview of taxable income. A comprehensive definition of income, although attempted in the Income Tax Systems of some countries like Canada may not only be difficult to achieve but would restrict the scope of the tax rigidly to the types defined with the result that avoidance by making income partake a character which does not bring it within the letter of the law may become common. The significance of the term 'income', its scope, its nature and the forms it can take have been the subject of judicial interpretation in numerous cases, so that there does not now appear to be any ambiguity or doubt as to its real meaning. The assessee public has no misconceptions about the term. A precise definition by statutory enactment would set inflexible bounds where now there is an elasticity which would appear to be more desirable from the point of view of the Revenue.

Question 48.—Among the receipts or gains which are not taxed at present but which may well be brought within the scope of the tax are casual income and compensation for loss of office or termination of employment. Agricultural income and the income of religious or charitable institutions to the extent mentioned by us in answer to Question 56 do not, it is considered, permit a disturbance of the *status quo* for tax purposes, one because of the constitutional position and the other because of the strong public sentiment in favour of encouraging charities and of the useful purpose that they serve in public and social life. In the case of casual income, there does not appear to be any valid reason for its exclusion from the scope of taxable income. There is not infrequently a windfall element in such income which makes it an appropriate subject of taxation. The present treatment given to compensation for loss of office or employment as a capital receipt has amounted to treating what in reality is an income receipt as though it were a capital receipt. This compensation

takes diverse forms. Types of tax avoidance and the corrective action taken in the United Kingdom may well provide a lesson to us.

The following extract from the speech of the Chancellor of the Exchequer when presenting the Budget for the year 1950-51 may be of interest: "Two years ago I referred in my budget speech to the growing avoidance of tax by means of arrangements known as restrictive covenants, among others. The form taken by these is that a high executive undertakes not to set up in competition with the concern he serves or to serve its competitors. In return the concern gives him a large sum of money or block of shares which as the law stands is not liable to tax. I gave a warning in 1948 that I should not hesitate to introduce retrospective legislation to tax such payments if it became necessary. Since then glaring instances of such payments have been widely advertised and I am certain that the public and particularly those employed in the businesses concerned do not think it right that a particular individual should by such a device be able to evade paying his proper share of taxation. The payment of such sums is too entirely contrary to the spirit of the policy of the White Paper on Personal Incomes, Costs and Prices and can only help to break down the otherwise good record of voluntary restraint that has so far been shown in these matters. I propose, therefore, that these benefits shall be made chargeable to surtax and that the charge shall be retrospective to the year 1949-50 so that payment will have to be made next January on such benefits. In the case of the larger sums this means that over 95 per cent. of them will be payable as tax". The actual provision suggested to meet the evasion was in these terms:

"That (a) where an individual who holds or has held or is about to hold an office or employment gives an undertaking whether absolute or qualified and whether legally valid or not, the tenor or effect of which is to restrict him as to his conduct or activities and any sum is paid or valuable consideration given to him or to any other person in respect of the giving or total or partial fulfilment of that undertaking such additional surtax shall be charged in respect of the income of that individual as may be determined by any Act giving effect to this resolution;

(b) this resolution shall be retrospective but tax shall not be charged by virtue thereof for any year before 1949-50".

Effective measures may, therefore, be taken under the Income Tax Act to give what virtually are revenue receipts the complexion of a capital receipt and avoiding income tax thereby.

Regarding taxing of capital gains, it is felt that it is an eminently suitable subject and the old provision Section 12B in the Income Tax Act may well be revived. It may be argued that now that it is certain that an Estate Duty will be levied on property passing on a death, as such gains will be included in the estate and as the estate will come in for duty at the death, there is no need for the capital gains tax being interposed.

It may be that the capital gain thus brought in for capital gains tax eventually finds its way into his estate and comes in for charge for estate duty at his death; it may also be that it is disposed of *inter vivos*. In any case there can be no harm in taxing a gain at the moment it arises.

Question 49.—The present position is that a resident in India has to pay tax on the income that accrues to him in India, on the income that accrues to him outside India and on the remittance into India out of the profits which had accrued to him without the taxable territories before the beginning of the year and after the 1st April 1933. In the case of a non-resident, it is limited to the assessment of the profits which accrued to him out of the taxable territories in the year under consideration. The concession granted to a person not ordinarily resident in the taxable territories is only this; that the profits or gains which accrued to him without the taxable territories cannot be considered for purposes of the assessment unless its profits arise from a business controlled within the taxable territories.

The question whether in the case of a resident it is proper to bring within the assessment the profits which arise without the taxable territories came up for consideration before the Royal Commission on the taxation of Profits in the United Kingdom. In the first report the Commission has presented on this subject the learned Commissioners relying upon the findings of the Royal Commission on Income Tax in 1920 held that the non-taxation of foreign profits of a resident would virtually

amount to a premium on the export of capital and that there is no case whatsoever for exempting such profits from taxation. To quote the words of the Royal Commission of 1920: "In view of the present demand for capital to develop home industries, should we be justified in recommending differential tariff which will be more and more favourable to the British resident as we employ more and more of the capital abroad? Presumably capital is attracted to foreign countries in view of the higher taxation in this country. Could we say that two traders residing here earn profits one from trading in foreign countries and the other from trading within U. K. and pay unequal amounts of tax? Moreover we should be reluctant in our present national circumstances to suggest any measure that could possibly be interpreted as a suggestion that a bonus should be paid on the export of capital". These words exactly represent the present position in this regard in India. There is no case therefore for exempting foreign profits in the case of Indian residents from taxation. Now there is the other question whether Indian businessmen abroad who for purposes of taxation had been non-residents should be given concession in the matter of accumulated savings being brought to this country. If such accumulated savings are remitted to India by Indian businessmen during the period of their non-residence such accumulated savings are exempt from taxation. The position, however, changes immediately they establish their residence in this country. Recently the Government has given concessions exempting from taxation foreign profits which are remitted to India by such non-resident persons in the first two years of their becoming resident in India. This apparently was given on account of the representations made that due to currency or exchange restrictions it was not possible for them to repatriate the funds all at once. This concession may be continued and in some cases even extended wherever necessary. This has to be done by reference to the difficulties experienced in the different countries.

The present system of taxation perhaps will place undue hardship where the same income is taxed in the country of origin and in the country of residence when there is no agreement between the two countries for relief in respect of double taxation. In all such cases the hardship if any will have been removed when full credit for tax paid abroad is given in the Indian assessment. Such concessions have already been given by the Government.

Question 50.—The present definition of 'dividend' brings within its scope any distribution by a company out of accumulated profits as long as such distribution entails the release by the company to its shareholders of all or any part of the assets, any distribution by a company of debenture or debenture stock to the extent to which the company possessed accumulated profits and any distribution made to the shareholders out of accumulated profits on the liquidation of the company as long as the distribution is out of profits accumulated during a period of six years preceding the date of liquidation. When debenture stocks are being taken for purposes of taxation as dividend there is no justification for excluding bonus shares for purposes of taxation. One of the commonest forms in which avoidance of taxation took place was bonus distribution in the form of redeemable preference shares. It is true that now the Capital Issue Control Department does not permit of such distributions in the form of redeemable preference capital. The only form in which it is to be done is in the form of ordinary shares. But even here there is no justification for excluding bonus shares for purposes of taxation. The recipient does not have to pay income tax, such tax having been paid by the company. There is no reason why he should not pay it at the time of distribution in the form of bonus shares.

Question 51.—We have re-read the observations of the Income-tax Investigation Commission on these two sections and we have also seen the comments made in paragraph 7 of the Chapter headed 'Taxation and Export' of the Report of the Export Promotion Committee presided over by A. D. Gorwala. Neither of them have found it necessary to suggest any amendment of the sections; indeed their view appears to be that no exception could be taken to the principles embodied in these sections. If in the practical administration of the provisions, some hardship is caused, and there would appear to be some evidence that it is caused, such as the personal liability of the agent selected for payment of the tax due, that can be remedied by suitable instructions given by the Board to assessing officers. The sections themselves do not appear to call for any modification.

Question 52.—Reference has been made by us to the Agricultural Income-tax Acts of two States, West Bengal and Uttar Pradesh. 'Agricultural income' is defined in these two Acts in the same terms as in the Indian Income Tax Act. Under the Indian Income Tax Act 'agricultural income' is exempt from income-tax [Section 4(3)(viii)]. Under the Agricultural Income-tax Acts of the States referred to, this 'agricultural income' is taxable. Thus while these Acts are mutually exclusive, it is not understood how a possible conflict between the

taxing authorities can arise, assuming that in respect of Agricultural Income-tax Acts in operation in other States, the definition of 'agricultural income' is identical. To take the instances given in the question one by one, 'income from forests', if the income results from produce of a spontaneous nature on which no human effort in the way of cultivation has been expended, it will be subject to Indian income-tax; and for the same reason, that it does not arise out of any agricultural operations, it will be excluded from the scope of the Agricultural Income Tax Acts. If on the other hand, the income from forests arises as a result of afforestation or cultivation operations, the income will be agricultural and will be excluded from the scope of the Indian Income-tax Acts by virtue of Section 4(3)(viii) and being agricultural income it would be taxable under the State Acts. Then as regards dividends from agricultural companies, the Bengal Act contains elaborate provisions for computation of tax on mixed incomes, that is, incomes which partake of the nature of both agricultural and non-agricultural income. If the other State Acts contain similar provisions, there would not appear to be any occasions for overlapping of the jurisdiction of the two taxing authorities.

Question 53.—Yes, and there is a precedent in the Estate Duty Act where for rate purposes agricultural land in a non-scheduled State is included with other property.

It would be more fitting if the Centre as the authority having the residuary sources of tax had the right to benefit of aggregation of non-agricultural income with agricultural income. The principle of aggregation should be unobjectionable as it aims at determining what tax the subject can bear. But if more than one taxing authority had recourse to the principle of aggregation for purposes of its tax rate, it may be inequitable to the subject. The better thing would be for the Central Government to come to an understanding with the State Governments.

Question 54.—We are aware that this is an entirely artificial distinction imposed by the Constitution largely as a result of historical accident and further that this kind of dichotomous division of income does not prevail in the tax systems of most countries with a federal constitution, complicating legislative and administrative measures. This artificial distinction applies not alone to income but to taxes on capital also: for instance, under the Constitution, Parliament is competent to enact legislation by way of Estate Duty and Succession Duty only on property other than agricultural land; and it is the sphere of the States to impose these taxes on agricultural land. Even as regards capital gains the Central Government's powers would appear to extend only to capital gains in respect of property other than agricultural land. Even so, we would recommend the maintenance of the *status quo*, so that State Governments may not have a feeling that they have been compelled to surrender two or three of the few sources of tax revenue available to them for exploitation, however desirable unification be on a number of considerations.

Question 55.—The second part of the question is understood to refer to cases such as interest on cash certificates issued by Banks for say, a three years or other term. The practice appears to be that at the end of the term, the interest received or receivable on maturity is taxed in the relevant assessment year and the tax being on the entire interest accrued over a term the rate of tax may conceivably be higher than that which would be applicable if the interest were to be apportioned over each year of the term and tax charged on such portion in the relative assessment year. This would appear to be the equitable method of dealing with such cases but perhaps under the terms of issue, the entire interest is due and receivable only at the end of the term, and no interest or only a reduced rate of interest may be claimable if the principal sum is received earlier. This may raise a doubt as to which amount is to be taken for the annual assessment, but a notional, rough and ready apportionment can be made.

Other cases of a like nature are a contractor's profit on a work which has taken him some years to complete or a liquidator of a company who receives a lump sum remuneration for a liquidation which takes longer than a year or two to put through. Although the receipt of the income may be in a particular year, it really represents income which has to be spread over the period of the work. In such cases, particularly in the assessment of contractors, the Department has been known to take a fair and reasonable view in spreading the income over the work period.

A provision based on the same principle is contained in Section 60(2) of the Income-tax Act in regard to salaries.

An analogous provision, in the case of authors or artists who receive royalty or copyright fees for work which has taken more than one or two years, is Section 12AA of the Income-tax Act.

Question 56.—Before considering the question whether any modifications are necessary in the provisions of the

Act which exempt from liability to tax the income of religious and charitable trusts, an exemption which may well be described in the words of Lord Nathan's Committee on the Law and Practice relating to Charitable Trusts in the United Kingdom (1952) as constituting an "immense hidden subsidy" by the revenue to voluntary effort, it may be useful to assess the place and function of these charities in public and social life. As Lord Beveridge observe: "In a totalitarian Society, all action outside the citizen's home and it may be much that goes on there is directed and controlled by the State. By contrast, vigour and abundance of voluntary action outside one's home, individually and in association with other citizens for bettering one's own life and that of one's fellows are the distinguishing marks of a free society". Voluntary Charities are encouraged in most democratic countries as "it embodies the sense of responsibility of private persons towards the welfare of their fellows and as it meets by private enterprise, a public need". It may be thought that now that we have a Welfare State as contrasted with the law and order State of earlier days there is not much room for voluntary private action in the matter of public charity. How mistaken such an impression it would be evident from the following observations of the Committee above referred to. They say: "At no time however can we discern any antithesis between public and private welfare or the making of any fundamental distinction between their aims and functions; and today the public services for social welfare are carried out with the help of innumerable voluntary workers and by making use to an important extent of voluntary agencies; so far from voluntary action being dried up by the extension of social services greater and greater demands are being made on it. We believe indeed that the democratic State as we know it could hardly function effectively or teach the exercise of democracy to its members without such channels for and demands upon voluntary service". In our country, the merit and virtue attaching to charity have been impressed from time immemorial by all religions. A tax concession to charity is, therefore, undoubtedly proper and deserved.

Even so, we would like to see a distinction drawn between 'endowed' and 'non-endowed' trusts for purposes of tax treatment. By an 'endowed trust' we mean one where there is a corpus of property, it may be land or it may be a fund in diverse forms, endowed perpetually, and only the income thereof is applied to charitable purposes without affecting the corpus, a category which may be said to correspond to the type of charity contemplated in Section 4(3)(1) of the Income-tax Act. A 'non-endowed trust' in our view is one where property is in the nature of a business and the profits are devoted to a charitable purpose, a category contemplated in Section 4(3)(1a) of the Act. In the case of an 'endowed trust', conforming to the tests laid down, the income should continue to enjoy the exemption. Where however the trust is a non-endowed one, that is, where a business is carried on by a charitable institution and the profits are applied solely for the purposes of the institution, the justification for exemption from tax does not appear to us to be as strong as in the case of endowed trusts. Such non-endowed trusts may well satisfy the normal tax demands first and apply the residue for their purposes. We make this suggestion as we feel that Government's needs for funds, part of which go for equally deserving public welfare purposes are no less great. We do not suggest that institutions which derive their income from voluntary donations should be in any different position *vis-a-vis* income tax exemption from what they are in now. Our recommendation in respect of non-endowed trusts is influenced by the fact that in recent years it has become a common practice with assesses with large incomes to create institutions of this nature, which may not be the case if there were no advantage to be derived therefrom. An amendment made this year permits the accumulation of the income of charitable institutions and makes the income when it ceases to be so applied subject to tax but it is feared that a profit may be made and lost in the next subsequent year so that both the charity and the revenue may be cheated. If our suggestion is accepted, this may be prevented.

Question 57.—The exemption in respect of profits of Co-operative Societies has been in force from 1925 and old practice coupled with the fact that co-operative enterprises for rehabilitating refugees and for some kinds of Community Project Schemes under the Five Year Plan may be the most suitable agencies for such work would seem to justify a continuance of the concession. On the other hand some distinction may legitimately be drawn between purely mutual co-operative societies and societies which trade with the public such as marketing societies. In the case of the latter the claim for exemption would appear to be not as strong as in the case of purely mutual societies.

The early view on the liability or non-liability to income-tax of profits arising to Co-operative Societies was laid down thus by the Madras High Court in *E. & S. Joint Co-operative Wholesale Society Ltd. v. Commissioner of Income-tax, Madras* (3 I.T.C. 385):

"The Society cannot make taxable profits out of its own component elements, and with that starting point established, it is to my mind immaterial that the moneys which came into the hands of the 'Apex' Society are distributed in the form, in part, of a dividend to shareholders so long as these shareholders do not include any person who is not a member of the Co-operative Society".

This view was considered by the Privy Council in 1948 and set aside by them. Explaining what kinds of businesses may claim exemption from liability to income-tax under the principle laid down in the *Style's case*, namely, that a society being a purely mutual co-operative society making no profits was not liable to income-tax, their Lordships were of the view that "this principle cannot apply to an Association, Society or Company which grows produce on its own land, or manufactures goods in its own factories, using either its own capital or capital borrowed whether from its members or others and sells its produce or goods to its members exclusively".

The principle appears to be this, that where in a mutual society no profits are made out of transactions between the Society and the members such as a mutual Insurance Society there is no occasion for the tax, but where the Society is trading concern and carries on business whether with its own members or with the outside public and out of the business it derives profits which it distributes to its members it should not escape tax.

As Section 18 of the Co-operative Societies Act, 1912 provides that a society registered under the Act is a "body corporate with perpetual succession and a common seal, with power to hold property, to enter into contracts and to institute and defend suits and other legal proceedings" it would not be inappropriate if such societies are treated for tax purposes as though they were companies.

Co-operative Housing Societies may be treated in the same way as a mutual non-trading co-operative Society and held to be exempt from income-tax on its rental income. There is some justification for such a treatment as with the pronounced shift of population to cities and with housing construction programme in our cities being very much behind public requirements, an incentive may be provided. There is the analogy of Section 15e in the case of new industries.

Question 58.—The generous initial depreciation allowances have rendered the concession under Section 15e of the income-tax Act unnecessary and the Section may well be repealed. It will be recalled that this concessional treatment was the result of the four-pointed anti-inflationary Policy set in motion in November 1948. It was then considered that special steps were desirable to stimulate production and accordingly, depreciation allowances were liberalised, new industrial undertakings were exempted for a term from payment of income-tax and certain reliefs in respect of customs duty on imports of plant and machinery and raw materials were given. It is now felt that conditions prevailing today do not call for the continuance of all these concessions simultaneously or on the same liberal scale.

Question 59.—To the extent that foreign branches of Indian banks would assist the handling of India's foreign trade to our greater advantage, and would earn foreign exchange by invisible exports, they are entitled to some consideration but we do not see how with the present position of the law, any further modification is rendered necessary. It is true that the Import Control Advisory Committee (1950) made a suggestion in its report to Government that Government do everything they can to increase our invisible earnings of foreign exchange by encouraging the use of the services of Indian shipping, insurance and banking for the transport and finance of our foreign trade. The Export Promotion Committee also made a suggestion of tax concessions being granted to offices of Indian firms opened in overseas countries. Pointing to the changes desirable in the pattern of our export trade, the Fiscal Commission also observed: "Historically the search for new markets has been accompanied by the growth of national shipping; the latter is a substantial aid to the opening up of new markets. Similarly the establishment of banking and insurance houses will also facilitate the development of India's exports in the comparatively undeveloped markets of the Middle and Far East where the tie-up of existing financial or commercial interests may often place newcomers in the field at a disadvantage". Now, Government have already explained that in respect of countries with which India has concluded Double Taxation Relief Agreements, there will be no question of double tax on the same income. Where tax is charged in a country with which India does not have a reciprocal agreement for double tax relief, Section 49D of the Income-tax Act as amended by Act 25 of 1953 provides that an assessee "shall be entitled to the deduction from the Indian income-tax . . . of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country whichever is the lower". We do not think that any larger concession would, in the interests of the revenue, be justified nor

do we think that the foreign branch can legitimately expect more.

Question 60.—No further liberalisation, in our view, is called for; the existing exemption is generous enough. An illustration will make the position clear. The maximum exemption available in the case of the larger income assessee is Rs. 500 a month, an amount which will assure a policy money of over Rs. 1,20,000 at the end of a 20 year term assuming that the policy is taken up, say at the 30th year; in other words, a person earning Rs. 3,000 a month can claim exemption for as much as Rs. 500 a month for insurance premium; a person with that status, it seems reasonable to suppose, would hardly find it convenient to spare more for insurance.

Question 61.—On this question, we would respectfully endorse the conclusions reached by the Millard Tucker Committee which are summarised in para. 132 of their Report and which for convenience of reference are reproduced below:

- “(a) Whether the proposed schemes are based upon revalorisation or upon the creation of a reserve for replacement, in essence they all amount to a proposal that a business should be relieved altogether from tax on some part of its true profits, that is to say, upon its profits as computed on ordinary accountancy principles;
- (b) In fact this relief from tax would not apply to all businesses but only to those which require to replace fixed assets or stocks. To that extent, therefore, the treatment asked for would be of a preferential nature;
- (c) Where a business qualified for this preferential relief, it would do so, irrespective of the value of the business to the national economy;
- (d) None of the schemes of revalorisation or of reserves for replacement gives any relief or assistance in relation to a new business or to the expansion of an existing business;
- (e) All such schemes would involve considerable extra clerical work both on the part of the inland Revenue and the tax-payer;
- (f) Our suggestion for a system of flexible initial allowances is the only solution which meets the objections we have enumerated.”

In our own country the Tariff Board has more than once declined to accept this plea that depreciation should be allowed on replacement costs instead of on actual cost as is the practice now. To quote their observations in connection with their enquiry on the Fair Retention Prices of Steel produced by Tata Iron & Steel Co. Ltd.: “The representatives of the industry contended that depreciation should be calculated on the replacement value of plant and machinery. We have already dealt with this question in our reports on the prices of cotton yarn and cloth as well as of paper in which we have pointed out certain practical considerations which made it difficult for us to accept replacement cost as a basis for purposes of depreciation as also for return on fixed capital, although we recognise the vital importance of replacement. The proposal that depreciation allowance should be based on replacement costs has been found unacceptable even by professional accountants who feel that there is an element of uncertainty and arbitrariness in such a procedure. Instead they prefer the basis of historical cost both for depreciation and for valuation of stocks. They also suggest that additional sums provided for replacement should be regarded as reserves and treated as such in the accounts. Moreover there are other practical difficulties such as the possibility that costs of replacement might occasionally fall as also the fact that replacement does not always or necessarily involve the installation of an identical machine.”

This is a more temporary problem of finance. If necessary, Government should come to the aid of industries and grant temporary loans to enable them to incur the expenses of replacement. The Industrial Finance Corporation may be made the vehicle for giving this financial accommodation or another separate statutory corporation more or less on the lines of the Industrial Finance Corporation may be set up.

Question 62.—No change appears to be called for in the classification of assets for depreciation allowance purposes. As regards rates of depreciation, it would appear from the fact that plant and machinery have been known to be serviceable and working with reasonable efficiency for considerable periods after their supposedly normal life, as assumed for depreciation allowance purposes, the rates, as a general rule, err on the generous side. A closer approximation between effective life and spreading the allowance to cover the whole of this term is desirable and an expert committee of engineers may be consulted for advice regarding appropriate rates of allowance for depreciable assets.

The old method of computing the allowance on the ‘straight line method’ was given up on the advice of the Ayers Committee of 1935 and replaced by the present ‘written down value’ method. As it is claimed that

this is simpler for the Department, a disturbance of the position is not recommended even though the displaced system is not without merit.

Question 63.—In answer to Question No. 58, it was suggested that Section 15C of the Indian Income-tax Act may be repealed as the concessions given by it were really superfluous in view of the generous initial depreciation allowances. We would qualify that answer to the extent that Section 15C may be repealed save in respect of its application to new mining industries. On the question whether any depletion allowance should be given to mining undertakings, we agree with the Tucker Committee’s view as expressed in para. 233 of their Report “the general principle that an allowance should be given for all expenditure on assets that are used up in the carrying on of a business seems to us particularly applicable to the position of a concern which has to pay a capital sum of minerals or for the right to work minerals”.

Question 64.—(i) No change, in our view, is called for in the present position.

(ii) The same answer as in (i) above except to the extent specified in answer to Question No. 67 below.

Question 65.—In a period of high taxation, one of the legitimate reliefs to which an assessee is entitled is the reduction in the gap between the commercial concept of income and the income tax concept of income. Over a period of time this gap between the commercial concept and the income tax concept has become widened, on account of the judicial view taken on the admissibility of certain types of expenses.

At present the residuary clause in Section 10(2)(xv) is in very wide terms. Unlike as it used to be, it is not necessary to show that the expenditure is incurred for the purpose of earning the profits. It is only necessary to show that it is laid out for the purposes of business.

In particular the following expenditure should be allowed: (1) expenditure incurred in connection with income tax appeals, particularly when the appeals are decided in favour of the assessee; (2) in the case of deferred revenue such expenditure should be allowed in instalments in three or four years; (3) where expenditure is incurred in connection with the maintenance of the reputation of a business such expenditure should be allowed, particularly when the assessee is acquitted in such cases; (4) Expenditure necessarily incurred for maintaining the corporate status should also be allowed. (5) In the case of lump sums paid for acquiring leases such expenditure should be allowed over the period of lease.

Under Section 10(2)(vii) allowance for loss is only given in the case of plant and machinery and buildings. Such concession should also be given in the case of Furniture and Fittings.

Question 66.—(a) Both from the point of view of the assessee and of the administration, we would advocate the amalgamation of income tax and super tax. Historically, the reason for keeping the super tax a separate levy was that it was intended to be a temporary measure withdrawable at a convenient time; but now that super tax has become a permanent feature of the income tax system and there is no requirement in the Constitution that it should be treated separately as in the case of Corporation Tax, much advantage in the way of saving of time and labour is to be derived by consolidating the two. If this is done, then appropriate changes in the law will have to be made for there are certain items which are only allowed for purposes of income tax and not super tax.

(b) It will be found convenient to both, in that calculation of tax would be much simplified.

(c) The degree of progression is illustrated by the Table below:

Income.	Income Tax, Surcharge and Super tax & Surcharge.	Income less Tax.
Rs. 1,00,000	50,063	49,937
Rs. 1,50,000	89,438	60,562
Rs. 2,00,000	1,30,454	69,546
Rs. 2,50,000	1,71,469	78,531
Rs. 3,00,000	2,12,485	87,515
Rs. 3,50,000	2,53,511	96,489
Rs. 4,00,000	2,94,517	1,05,483
Rs. 4,50,000	3,35,532	1,14,468
Rs. 5,00,000	3,76,548	1,23,452

With the steady progression in rates it would appear that in the higher ranges of income, the incentive to make a large income is discouraged because of the

disproportionately decreasing reward available to the assessee; on the other hand, it should be remembered that the capacity to bear the burden is the guiding principle. The State moreover is firmly committed to the principle of reducing grave inequalities of income and wealth and it can only be implemented by a scale such as this. There is the further argument that it is because of conditions created by the State that the earning of large incomes is possible and it should be open to the State to determine what part of the income may go to the assessee and what part to the State. It is human nature to be dissatisfied with all taxes and to complain of their adverse or prejudicial effects but the gloomy forebodings seldom come true, at any rate to the extent predicted.

(d) It is not considered that any change is necessary and in our view frequent changes are undesirable because just when people had settled down to a state of things, a disturbance of the position and the time taken to become familiar with the new situation may cause no small inconvenience to the public.

(e) A surcharge at a flat rate of 5 per cent. falls with unequal incidence in that, although it is strictly proportionate, it works out unequally when the capacity to bear the burden is considered and consequently at a uniform rate the surcharge works out to be a heavier burden on the relatively lower income groups than on those higher up in the scale which can bear a higher rate of surcharge. As the object of imposing a surcharge is to enlarge the revenue there is no reason why it should not be graduated and be made to yield a substantial revenue.

Question 67.—The exemption limits should be retained at their present level until there is clear evidence that prices have been stabilised at lower levels when the exemption limits may be correspondingly lowered. On the other hand if the inflationary trend continues and the general index of prices shows a further rise it may be necessary to fix the exemption limits at higher levels.

Question 68.—The distinction between earned and unearned incomes should continue to be maintained. The present reliefs are fair and equitable, but attention is invited to the fact that on the higher ranges, the margin of differences between the tax on wholly earned and on wholly unearned tends to grow narrower as the income range gets higher. By way of illustration, we set out some of the figures given in the Statement contained in the Explanatory Memorandum to the General Budget (1952-53), page 94:

Income.	Tax as percentage of income, where income is wholly earned.	Tax as percentage of income, where income is wholly unearned.	Difference.
12,000	5.8	9.5	3.7
13,200	6.5	10.4	3.9
14,400	7.2	11.2	4.0
15,000	7.6	11.5	3.9
16,800	8.4	13.1	3.7
24,000	12.7	17.0	4.3
25,000	13.2	17.4	4.2
48,000	30.0	32.2	2.2
55,000	32.8	34.8	2.0
60,000	35.6	37.3	1.7
70,000	39.9	41.4	1.5
90,000	49.0	50.1	1.1
1,00,000	50.1	51.1	1.1
1,50,000	59.6	60.3	0.7
2,00,000	65.2	65.7	0.5

It will be seen that in the lower ranges of income, the difference is as much as about 4 per cent. whereas in the range above Rs. 1,00,000 the disparity gets gradually blurred and is in fact even less than 1 per cent. On a higher range of wholly unearned income, it would appear legitimate to expect at least a proportionately higher tax. The slab rates would appear to require a careful revision to give this result.

(b) We have no modification to suggest in the definition of "earned income" which appears to us to be satisfactory.

(c) A slight readjustment would appear desirable and it is suggested that the earned income relief should be one-fourth or Rs. 5,000 whichever is lower. It has already been suggested that in the higher ranges the disparity between earned and unearned incomes should be steepened not blurred as is the position now.

Question 69.—The present practice of taking the value at cost or market whichever is lower does not appear to call for any disturbance. This would appear to be the most equitable basis for valuing stocks. This matter was considered at length by the Institute of Chartered Accountants in England and Wales. After enquiry they came to the conclusion that this basis did not call for any change. This principle has also been accepted by the Millard Tucker Committee.

Question 70.—Where a Hindu Joint Family consists of two or more adult male members, the incidence of the tax would be made fairer if instead of taxing the income at the rate appropriate to the total income, to tax it twice on two split portions. An illustration may help to give a clear idea of the suggestion. Suppose the income of the Hindu family is Rs. 20,000. It would be assessed to twice the amount of tax on Rs. 10,000 and not at the higher rate applicable to Rs. 20,000. This may give some relief to such assesseees.

Question 71.—Provided the surrender is made *bona fide* in the interests and for the benefit of the managed company, and not for the purpose of avoiding or reducing super tax liability of the Managing Agents, the voluntary surrender may be permitted by suitable provision in the Act.

Question 72.—The old Double Income Tax agreement with the United Kingdom involved a somewhat elaborate procedure which in practice occasioned considerable inconvenience and delay. A type of agreement which would reduce these to a minimum is that concluded between India and Pakistan in 1947 which may be taken as a model for agreements with other countries.

Question 73.—The only comment that we have to offer is that the 6 per cent. of the 'annual value' allowed for collection charges does not always cover the actual expenses. It is suggested that discretion be vested in the Board to relax the rule in cases where the collection charges are shown to its satisfaction to be actually higher.

Question 74.—A change is required in respect of provisions relating to carry forward of losses in the case of cessation of business, and we suggest that where a business is discontinued, unabsorbed losses should be allowed to be carried backwards for a period of two years and allowed to be set off against any profits made in those years.

We would further suggest that even in the case of a going concern, the loss should be allowed to be carried backwards for a period of two years immediately preceding the year of assessment, in which case, the carry forward may be restricted to four years for the balance of the losses which are not absorbed by carry back to such two immediately preceding years.

Another amendment that we would like to make is that the word "same" occurring in Section 24(2) should be deleted.

Question 75.—It is suggested that dividend income should not be subject to advance payment of tax under Section 18A except where the dividend is actually received. We suggest, therefore, that dividend income should be subjected to the same treatment as Managing Agency commission under Section 18A(4).

If, after the service of the notice, an assessment in respect of a previous year later than that referred to in the original order of the Income Tax Officer for purposes of Section 18A is completed, then the assessee should have the option of paying the tax in accordance with the income computed in the later order. This should not depend upon the discretion of the Income Tax Officer as it would appear to be at present. The section gives the assessee the right to estimate his own income for purposes of Section 18A. In such cases the excess tax collected in the earlier quarters should immediately be refunded. In the case of a new business the assessee should have the option of paying the Section 18A within three months of the close of the year. This concession should be granted to new businesses only in respect of the first year of its existence.

Question 76.—In respect of fraudulent concealment of income there is no reason why there should be a time limit at all for re-assessing escaped income. Such concealment is a crime. There should be no right of limitation in respect of any crime.

In other cases it is only proper that there is a time limit; and in our opinion the time limit has been correctly fixed at four years. There is one aspect of the matter, however, that deserves to be considered. The section as it stood before it was amended in 1948 used the following words: "In consequence of definite information which has come into his possession the income Tax Officer discovers that income, profits or gains chargeable to income tax have escaped assessment" Now the section as amended enables the Income Tax Officer to take action if "the Income Tax Officer has in consequence of information in his possession reason to believe". The present section has omitted the words "definite", "come into", and "discovers". But still the Income Tax Officer can only take action if in

consequence of information in his possession he has reason to believe that income has escaped assessment. Although much of the mischief has been removed, still the present words impose a certain amount of restriction on the initiative of the Income Tax Officer. It is not necessary that in such cases when it can be shown that income has escaped assessment, the Income Tax Officer should suffer from such restrictive provisions. The section should be so amended as to make it possible for the Income Tax Officer to issue a notice for re-assessment whenever he has reason to believe that some income has escaped assessment. As has been mentioned in an answer to a later question this is one of the reasons why there is considerable delay in the completion of the assessments by the Income Tax Officers. Because of these restrictive provisions the Income Tax Officer has to be very careful before he completes the assessment. The removal of these restrictive provisions will enable the Income Tax Officer to complete the assessments without delay for in the event of something having escaped assessment he can at any time within four years take suitable action.

When such a right is given to the Income Tax Department it is only proper that the assessee should likewise have a remedy available to him whenever he can show within a period of four years that either he has been over assessed or some deduction due to him had been omitted to be claimed. Such right can be given to the assessee by either widening the scope of Section 33A or 35 of the Income Tax Act.

Question 77.—This question is not understood. A certain minimum cost has necessarily to be incurred by every assessee in complying with the tax regulations. There is no extra cost in the maintenance of books so far as companies are concerned. Companies necessarily have to maintain certain minimum records in compliance with the requirements of the Indian Companies Act. In the case of partnerships, again, proper accounts have necessarily to be maintained, for the purpose of determining the rights of the partners *inter se*. In the case of individual assessee there are very few who do not maintain proper records. But if any expenditure has to be incurred it cannot be avoided and it is not expenditure solely on account of compliance with tax regulations. In many of these instances professional help will also have to be taken by the assessee. Any expenditure incurred in this connection again cannot be helped.

Question 78.—The Appellate Tribunal should not be given the power to enhance assessments. In fact even the Appellate Assistant Commissioners should not be allowed these powers. Section 33B gives power to the Commissioner to interfere in such cases. The scope of Section 33B, if necessary, may be widened.

Question 79.—At present a rebate of tax is available to a public company with a total income not exceeding Rs. 25,000. The difference in the rate of tax between small and large companies is enough and no further complicated reliefs such as progression in rates would appear to be desirable.

Question 80.—(i) The rebate now available to public companies with an income of less than Rs. 25,000 would be applicable to small industries if they are incorporated.

So far as small industries newly established are concerned, it may be recalled that clause 17 of Bill No. 56 of 1951 to amend the Income Tax Act proposed to extend the exemption to smaller industries employing 25 persons and more. Actually, the amendment made by clause 10 of the Amendment Act No. 25 of 1953 is even more liberal in that it enables the benefit to be taken by new industrial undertakings which employ ten or more workers in a manufacturing process carried on with the aid of power or employs twenty or more workers in a manufacturing process carried on without the aid of power. As however we have previously suggested that this section may well be repealed in view of the generous allowances by way of initial depreciation, the rebate in tax rate is all that seems to be necessary in the case of these small industries.

(ii) Cottage industries may for purposes of relief be treated in the same way as small industries. As however the tax rebate applies only to public companies, the benefit may be extended to new small industrial concerns and to cottage industries regardless of their status. Any other treatment might involve much administrative work of a complicated nature unlike the present system of tax rebate which appears to have been working well.

(iii) & (iv) No change in the present position appears to be called for.

Question 81.—There appears to be no justification for any change. The suggested exemption may well lead to tax avoidance. The Investigation Commission was of the view that this liability to Corporation tax at every stage is some deterrent to avoidance of tax by the method of setting up companies. If the benefits of incorporation are desired, companies are set up with a full knowledge of how much they will cost and what the countervailing advantages are. In many cases, the balance of advantage is carefully assessed and private companies are not

formed without a purpose. In such circumstances exemption from Corporation tax may mean indirect encouragement of tax avoidance.

Question 82.—The present provisions regarding banks and mutual insurance companies are satisfactory and there appear to be no complaints from these interests. In the case of banks there is no dissatisfaction about the allowance of bad and doubtful debts and in the case of insurance companies expenses, which the Controller of Insurance regards as reasonable, are allowed.

Question 83.—A rebate of one anna from income-tax is now given for undistributed profits. This differentiation is enough and no further concession appears necessary. It is however suggested that when undistributed profits are capitalised and issued in the form of bonus shares, the rebate given to the undistributed profits earlier should be recovered by the Revenue.

The benefit of the rebate should apply to all industries without any discrimination.

Two suggestions which we would put forward are—

- (1) the limit of 60 per cent. of the profits to be distributed, prescribed under Section 23A should be raised to 100 per cent. and companies subjected to the section should be assessed as though they are partnerships. If this suggestion is considered likely to retard industrialisation even in a small way, then the limit may be fixed at 75 per cent;
- (2) companies which are subject to Section 23A are those in which the public holding of shares carrying voting power is less than 25 per cent. If at least 25 per cent. of the shares of the company are allotted unconditionally to members of the public then it ceases to be subject to the provisions of Section 23A. The provision should really be that it is only in the case of a company where shares carrying a voting power of not less than 50 per cent. are held by the public, Section 23A should not apply.

Question 84.—We suggest that no departure from the present practice be made.

Question 85.—Such enterprises should pay the Government interest on capital and income tax on their profits like any non-Government concern. Of the balance that remains after taxes a portion may be taken by Government to general revenue. The balance may be kept reserved in the business for expansion, for meeting future losses if any, etc.

Question 86.—Chartered Accountants may well be made greater use of in the determination of taxable income of assessee with advantage to the Revenue in that part of the considerable time of the Income Tax Officers now taken up by the scrutiny of books and accounts would be released for other work by them. On the recommendation of the Income Tax Investigation Commission, the Income Tax Amendment Bill of 1951 proposed to provide that business assessee with an income of not less than Rs. 25,000 should submit their returns accompanied by accounts audited by a Chartered Accountant. It is suggested that while ordinarily this limit may be adopted, discretion should however be vested in Income Tax Officers even in cases where the income is lower to require the production of an auditor's certificate where he has reason to believe that the income returned is probably not correct or should be larger. Provision however may be made that this discretion shall not be exercisable save with the prior approval of the Commissioner of Income-tax.

It must be mentioned, however, that a Chartered Accountant's certificate must in the every nature of things be restricted to such transactions as have been brought into the books. If an item of expenditure is entered in the accounts the Chartered Accountant can ask for the production of the receipt or voucher in support of the expenditure. But when such receipts and vouchers are made available to him the Chartered Accountant cannot usually go beyond these. The Income Tax Officer's function, however, is different. He has to satisfy himself about the reliability of the accounts, receipts and vouchers, and satisfy himself when the expenditure claimed has in fact been incurred. Moreover a dishonest assessee may keep many of the transactions outside the books. In such cases the Income Tax Officer may with the extraordinary powers that he possesses under the Income Tax Act be able to unearth some of these matters. But with the utmost diligence the Chartered Accountant will not be able to do so.

In respect of public limited companies there will be no difficulty in accepting the Chartered Accountant's certificate. But in respect of firms and non-public companies it will be desirable to have a questionnaire framed under the Income Tax rules. The Chartered Accountant should be required to compulsorily answer these questions to the extent possible. For example, it should be possible for him to give details of the books maintained by the Assessee, report on the internal efficiency and on whether the transactions are vouched for by external evidence and if so, the extent to which

such transactions are so vouched and the basis adopted by the assessee for valuation of stocks and whether proper stockbooks have been maintained, etc.

These answers to the questionnaire would provide the Income Tax Officer with the basic information necessary to enable him to judge the extent of reliance he can place on the accounts and the extent to which they can be accepted for basing his assessment on them. This suggestion about the questionnaire has another merit. The Chartered Accountant may not often times be in a position to persuade the assessee to give all this information. But if it is made part of the Income Tax Rules then there will be no difficulty in his making the information available to the Department.

Incidentally it may be mentioned that when the basic information is brought on the record, the chances for corruption, if any, will be minimised, if not eliminated.

The questionnaire that has been suggested above should be framed by the Central Board of Revenue in consultation with the Institute of Chartered Accountants of India.

It is not recommended that auditors' fees should be prescribed statutorily but should complaints from assessee be numerous that the expense of getting their accounts audited is heavy and puts up the cost of compliance, then scales of fees may, in consultation with the Institute of Chartered Accountants, be fixed, having regard to the amount of work and time taken for doing it.

Question 87.—If the above suggestion is accepted, representation of higher income assessee would get to be concentrated eventually in the hands of Chartered Accountants.

While the present class of Income Tax Practitioners may be allowed to continue as at present, no further enrolment of practitioners should be made, so that this class whose efficiency cannot be as great as that of Chartered Accountants would become gradually extinct. Even for this class, a scale of fees may be fixed.

Question 88.—The names of delinquent assessee should undoubtedly be published and, in addition, where the concealment detected is proveable, offenders should be prosecuted and punished heavily as this is the only method of discouraging evasion.

Question 89.—There is considerable avoidance of tax by making remuneration take the form of perquisites. It is suggested that as clause 8 of the 1951 amendment Bill was a measure in the right direction it should be enacted. The present liberal treatment has been much abused and a provision such as that contained in the 1951 Bill would be fully justified. Further, there should be no arrangement for tax-free salaries to any employee.

Question 90.—An obligation should be placed on the liquidator to inform the Income Tax Officer of his appointment, just as the obligation placed on him under the Indian Companies Act in Section 214. Similarly the liquidator should only be permitted to make any distribution of the Company's assets after tax liabilities have been fully satisfied.

This by itself may not be found sufficient. Section 230 of the Indian Companies Act which deals with preferential payments gives priority to only such taxes as have become due and payable within the twelve months next before the date of the winding up. If an assessment is made and demand created after the date of the winding up resolution, it would not be an ascertained debt of the company on the date of the winding up and would not be entitled to be settled out of the assets of the company. It has been repeatedly held so by the courts. It would appear necessary for the Companies Act to be amended to provide that tax liabilities up to the date of the winding up resolution or order, whether ascertained or not, shall be entitled to priority of payment out of the assets.

Question 91.—The amendment Bill of 1951 sought to give by clause 38 the following further powers to Income Tax authorities:

1. To take evidence on oath.
2. To use the powers given under Section 37 of the Income Tax Act not only for a particular assessment but for all purposes of the Act.
3. To impound books of account placed before them.
4. To deal with cases of contempt.

The Amending Act 25 of 1953 has modified Section 37 to include only powers to impound books of account and to retain in custody books or documents for a period not exceeding 15 days, subject to certain safeguards.

If evasion is to be tackled effectively, the other powers contemplated by the 1951 Bill, which in this respect was drafted on the lines of the recommendations made by the Income Tax Investigation Commission, should also be conferred on the Income Tax authorities by statute.

Question 92.—The only precaution possible, it appears, would be to treat the members of a private company in the same manner as partners of a firm are treated

and the theory of the Corporation being a separate legal entity apart from the members composing it for the time being should be disregarded for tax purposes. In the other cases such as a family partnership or trust it is doubtful how this can be prevented because it may offend the elementary rights of association guaranteed by the Constitution. A partnership results from contract and if the members of a family enter into one to carry on business for profit, this cannot, it seems to us, be prevented. Nor can there be penal rates of tax in a case where the association is within the law.

Question 93.—Only the firm may be made liable for the unrealised tax, not the other partners individually.

Question 94.—When Income Tax Officers have to attend both to assessment work and to arrears collection work, the assessment work would naturally get behind schedule and there may not be enough time to give to assessment work with the result that efficiency might also suffer. If a separate machinery for collection of arrears of tax were established, it would free Income Tax Officers to attend more efficiently to current assessment work.

Question 95.—In the war years, it was a common practice to quickly form private companies, do some business connected with war supplies, receive payments and then to dissolve them before the Department moved to assess them. In such cases there can be no hardship if the shareholders of the company are held personally liable. Their interest in the capital of the Company would be an equitable measure of their tax liability.

Question 96.—We doubt whether it is legally possible to resort to property for satisfaction of tax liability of a person other than the ostensible owner.

Question 97.—The experiment, tried some time ago, of attaching Public Relations Officers in important centres to assist assessee in the making of correct returns may well be revived and reintroduced. They may give assistance in all the directions mentioned in the question. The primary consideration should be to simplify the work as much as possible for the assessee. The practice of fixing time for assessee to appear before the Income Tax Officer, in vogue for the last few years, appears to be working well. In other directions too, inconvenience to assessee may be saved as much as possible.

Question 98.—It is most important that facts, which form the basis of assessment and of all subsequent proceedings should be correctly found and fully recorded. Once this is done, the assessee is bound down to the record and no quibbling about facts later can be of any avail.

Some simplification has already been done in the evolution of two forms of returns of income, one for business assessee and the other for non-business assessee.

As regards (v) the administrative control over Appellate Assistant Commissioners should be vested in the Tribunal and in the Ministry of Law.

Question 99.—One contributory factor to the delay in completing assessments is the restrictive language of Section 34 which prevents an Income Tax Officer from re-opening an assessment except in certain contingencies. If he were free to re-open assessment in any contingency there would not be much hesitation in finalising assessments. It is suggested that Section 34 be amended to give greater freedom of action to Income Tax Officer.

Question 100.—The history of the Excess Profits Tax or the Business Profits Tax gives an indication of the conditions in which their levy would be justified. The Excess Profits Tax has been a war-time emergency levy and the justification for it is that the State because of the urgency of mobilising resources and finding supplies has necessarily to ignore considerations of economy; and people are enabled to make profits on a scale which would not be possible under peace-time competitive conditions. As the making of enormous profits are facilitated by the State, the State should be entitled to draw a part of them to itself. They are, therefore, purely emergency levies and should be resorted to only in times of emergency.

Question 101.—A mild instrument, perhaps designedly so, to bring about a less pronounced inequality of income and property in the social order. The achievement of the end, with the present rates, can only be very gradual and may take generations. However as time goes on it may be made more effective.

Question 102.—The suggestion is certainly novel but is deprecated because it would mean in practice an inquisition into the histories of the properties of the deceased, after the deceased, who in many cases, would be the only person who could throw light, has departed. The measure is new and in its experimental stage it would be unwise to alienate public sympathy by such reactionary discrimination. Further this basis does not appear to have been adopted by any of the numerous countries where estate duty is a feature of the tax system.

PART III—CUSTOMS AND CENTRAL EXCISES

Question 103.—(i) and (ii) The main classifications of the Indian Customs Tariff, as in operation on 1st May 1934 just before the coming into force of the Indian Tariff Act, 1934, were:—

- Part I.—Articles which were free of duty.
- Part II.—Articles liable to non-protective duty at special rates.
- Part III.—Articles liable to duty at 2½ per cent. *ad valorem*.
- Part IV.—Articles liable to duty at 10 per cent. *ad valorem*.
- Part V.—Articles liable to duty at 15 per cent. *ad valorem*.
- Part VI.—Articles liable to duty at 30 per cent. *ad valorem*.
- Part VII.—Articles liable to protective duty at special rates.
- Part VIII.—Articles liable to duty at 30 per cent. *ad valorem* or to preferential duty at 20 per cent.
- Part IX.—Articles liable to duty at special rates or to preferential duty at lower rates.

Each of these parts was sub-divided into three categories (1) Food, Drink and Tobacco, (2) Raw materials and produce and articles mainly unmanufactured and (3) Articles wholly or mainly manufactured. With a schedule in which the scales of duty were graded so steeply and in which entries were by no means precisely defined or classified, it is easy to imagine that conflicts between the Revenue and the trade should have been numerous, the Revenue contending and enforcing that a particular item fell within the higher rated category while the trade protesting in vain that the item was only liable at the lower rate classification. Although in the main *ad valorem* duty predominated, specific duties and tariff valuations were not known. The *ad valorem* duty, it may be pointed out, is not, in the first instance, a duty on the C. I. F. value as shown by the invoice but a notional value representing local wholesale market value and it is only if this proved to be unascertainable then duty is assessed on the value of the landed cost, that is, the C. I. F. value plus landing charges as a second alternative. Specific duties are computed by reference to weight (such as cwt.) or measurement (such as a yard or square yard). The tariff valuation is a variation of the specific duty in that a notional value was prescribed for a particular weight or measure and duty was assessed on that value.

The Tariff Act of 1894 with the numerous amendments having become not only unwieldy but very difficult for the trade to follow by reason of the introduction of protective duties and Imperial Preferential duties and the classification being out of date, the Indian Tariff Act, 1934 was enacted to consolidate the law relating to customs duties on goods imported into or exported from British India by sea or land. This Act, following the classification recommended by the Economic Committee of the League of Nations, contained a greatly elaborated schedule with twenty-two sections, which schedule in the main continues to be in force today. The present grouping appears to be relatively more satisfactory although minor changes from time to time according to the changing pattern of international trade for the elimination of products no longer entering the trade and for the provision of new products entering the trade may be necessary. Further, the Tariff Board and then the Tariff Commission have examined the claims of numerous indigenous industries to protection and where they have recommended protection by means of tariff duties being given, it becomes necessary to amend the Tariff Act. An Indian industry making out a case for protection may be interested only in a small part of a tariff classified item, so that when a protective duty is applied, it becomes necessary to segregate this particular part and sub-classifications emerge and the item becomes split up into two or more parts.

(iii) Correlation between Customs Tariff and Import Control Schedule. It was stated in the immediately preceding paragraph that the Tariff Act, 1934, which continues to be in operation, contains twenty-two sections under which goods are classified. The Import Control Schedule on the other hand has six broad divisions, devised mainly with a view to convenience of import control administration. The first dealing with Iron and Steel and manufactures is licensed in Calcutta by the Iron and Steel Controller. The second and third headings are licensed by the Controllers at ports. Consumer goods constitute another broad division, licensed mainly at the Ports. Industrial requirements and Machine Tools are the two other main divisions, the former being licensed at the ports and the latter by the Development Officer, Machine Tools at New Delhi. The discordant classification, the result of being devised to suit particular needs and the different purposes, the one a broad classification for purposes of trade control and the other a greatly detailed classification for purposes of revenue, has given rise to difficulties and at recent meetings of the Import Advisory Council the question has been dis-

cussed at considerable length. The difficulties experienced by the public have been found to be due to incorrect and inadequate description in applications for licence or incorrect customs tariff numbers being given in the licence and in such cases the customs authorities detain the goods as having been imported without a valid licence and no clearance, even on bond, is allowed. The advice given by Import Control to importers applying for licences was that they should give precise descriptions of the goods to be imported when, if on import the goods tallied with the description given in the licence, the customs would allow clearance of goods. It was also stated that greater co-ordination between the Customs Department and the Import Control would be established. It would appear that the Import Control Department does not favour a complete merger of the I. T. C. Schedule with the Customs Tariff but considers it desirable that the two systems should work in closer liaison in a manner made known to the trade and that in this way, the two systems will have freedom to act in a way suitable for their particular and different purposes and at the same time not create any difficulties to the public. The question of alignment of the Import Control Schedule with the Customs Tariff is believed to be engaging the attention of the Import Control Department when the difficulties now experienced by the trading public by reason of the disagreement of the schedules may be expected to be largely removed.

Question 105.—While there appears to be a judicious use of specific duties in the present tariff schedule, the trading public would welcome an extension of specific duties for the reason that the occasion for difference of opinion between the Revenue and the importer, namely, the ascertainment of the local wholesale market value, would not arise. This very fact would also hold an advantage to the Revenue in that collection of duty would become simpler.

Question 106.—(i) A tariff value, like a specific duty, is a more satisfactory basis for assessment of duty in that conflicts between the Revenue and the trader on the question of the proper local wholesale market value of the goods as in the case of *ad valorem* duties are avoided. But while from the point of view of administration, a tariff duty is simpler to administer, the interests of the Revenue and of the trade stand to suffer in certain contingencies. If after a tariff valuation is fixed, there is a rising trend in prices the Revenue loses the benefit of a higher yield which it might have got with an *ad valorem* duty. Conversely, the trader suffers a disadvantage with tariff value duties when there is a declining trend in prices. The loss of one is the gain of the other.

(iii) The procedure in connection with fixing tariff valuations appears to be that the Director General of Commercial Intelligence and Statistics circulates to Chambers of Commerce and other trade associations proposals to fix tariff values. The views of the commercial and trading public as represented by these organisations are considered and a decision taken by Government. The tariff values are generally fixed for the following calendar year some time in the previous December. This procedure is of long standing and there appears to be no need to modify it. In fixing values, the prices prevalent over a recent period appear generally to be averaged.

Question 107.—(i) Section 30 provides that assessments shall in the first instance be on local wholesale market value of the goods but that if this should prove to be unascertainable, duty shall be assessed on the landed cost of the goods.

In practice, the local wholesale market value, ascertained by Customs Appraisers seems to be not the importer's wholesale price but the wholesale market value at which the last wholesale dealer sells, which value is naturally bound to be higher as it includes the profit element of the intermediary wholesalers. The trade has also been dissatisfied with the local wholesale market value basis since it must include the wholesaler's profit on which duty becomes payable and which increases the amount of the duty. The landed cost basis would appear to be seldom resorted to, as under this basis, the value is bound to be less than the local wholesale market value where such value would include the wholesaler's profit. The Todhunter Committee considered that the alternative bases provided in Section 30 for assessing duty inverted the proper order and that assessment should really be the other way, namely, on the landed cost, that is, invoice value plus freight, insurance, unloading, landing charges, etc., and that the wholesale market value basis should only be resorted to if the invoice was not considered to be genuine or honest.

The principles underlying Section 30 of the Sea Customs Act, as viewed judicially, were explained by their Lordships of the Privy Council in two cases: Vacuum Oil Co. v. Secretary of State (1932) and Ford Motor Co. v. Secretary of State (1938). The following extracts from the judgments will be found to throw a good deal of light on the basic principles:

"Sections 29 and 30 are sections of a taxing Act and are not to be pressed against the tax-payer beyond their plain intendment and taken as a whole,

as their Lordships read them, they seem to disclose on the part of the legislature when describing the price which is to represent the "real value" of the goods to be taxed a definite purpose to define a price-conservative in its every aspect and free in particular from any loading for any post importation charges incurred in relation to the goods: The price is to be a price for the goods as they are both at the 'time' and 'place' of importation: It is to be a cash price, that is to say a price free from any augmentation for credit or other advantage allowed to the buyer; it is to be a net price, that is to say it is a price less trade discount. And this last expression supplemented by these other indications, confirms, in their Lordships' view, the conclusion that the words 'wholesale . . . price' are used in the Section in contradistinction to a 'retail price' and that not only on the ground that such is a well-recognised meaning of the words but because their association with the words 'trade discount' indicates that sales to the trade are those in contemplation and also because only by attaching that meaning to the word is the wholesale price relieved of the loading representing post-importation expenses which as a matter of business must always be charged to the consumer and which in the words of the Section already alluded to are so carefully eliminated The wholesale cash price, primarily in view is, they cannot doubt, that price current for staple articles, the amount of which if not a subject of daily publication in the press is easily ascertainable in appropriate trade circles. Their Lordships do not find in the Section any sufficient indication that the alternative basis of assessment indicated in Section 30(b) is only to be a 'dernier resort'. For the great bulk of dutiable goods in their infinite variety it must, they feel satisfied, be the only available basis."

From the concluding observation it would appear that the Todhunter Committee had a different conception when they stated their impression of Section 30 to be that "the effect of the Section is to make the duty on the higher value, namely that which includes the whole sale dealer's profit chargeable where the market value is obtainable and a duty on lower value where it is not" and that "the order of the application of the two clauses inverts the proper order of things".

In the second Privy Council case the following observations deserve particular notice; for they explain the significance of the last two sentences in the extract from the judgment in the Vacuum Oil Co.'s case.

"It is reasonably plain *in limine* that if such a wholesale price as satisfies the description contained in clause (a) of Section 30 is ascertainable the goods cannot be dealt with under clause (b) and the statute is not consistent with the view that the importer's profit should in that case be excluded from the assessable value. The price to be ascertained "is a wholesale cash price less trade discount for which goods of the like kind and quality are sold or are capable of being sold at the time of importation". In the application of Section 30 to the facts of a given case, something may depend on the exact force attributed to the requirement that the price must be 'ascertainable'. The words import more than could be satisfied by the result of a mere estimate. On the other hand the language of the Section "or are capable of being sold" does not exclude all possibility of arriving at the price defined by clause (a) upon the basis of an actual price though some adjustment may be needed to eliminate the difference, e.g., between cost and a month's credit."

"That the Legislature intended to exclude post-importation expenses need not be doubted but it had to do this in a practical manner without undue refinement and it must be taken to have regarded the phrase which it employed as sufficient for the purpose if taken in a reasonable sense."

So, it would appear to have been the intention of the Legislature that the real value was to be the wholesale value at the time and place of importation without any loading for post-importation charges. It presumably did not consider that for practical purposes of administration a greater refinement such as a deduction for the wholesaler's profit, should be made. Thus the wholesaler's profit comes to be included in the value and in a measure puts up the duty.

However, since political, economic and international trade conditions have now changed greatly, the introduction of a system of Consular Invoices may be considered. India now has embassies and consulates in most important countries of the world, that is, practically in all countries with which she has international trade. Exporters to India in those countries may be required to declare before the Indian Consulate to the correctness of the description of the goods, the price, the quantity, etc., in the invoices they send in relation to the goods exported. One copy of this Consular Invoice would be returned to the exporter and the other copy or copies forwarded by the Consulate to the Indian Customs authorities at the port of importation. A fee may be charged for these Consular Invoices. When the

Indian importer produces his commercial invoice as well as the copy of the Consular Invoice received by him from the exporter, at the time of payment of duty before clearing the goods, assessment of duty may be made on the basis of the value as borne out by the invoices without any further formality of enquiry into market values or other matters. Where a commercial invoice is not accompanied by a Consular Invoice, Customs authorities will be free to adopt whichever basis of assessment they consider proper in the particular circumstances of the case. The system would greatly simplify matters both to the Customs authorities and to the trade; as regard the trade, a rankling grievance of longstanding that duty as now assessed under clause (a) is not only on the landed cost of the goods but also on the wholesaler's profit would have been removed. The system of Consular Invoices seems to be in vogue among advanced countries and until recently our politically dependent status was a bar to its introduction but there is no reason now why we should not, with our embassies and consulates abroad, modernise our practices. The resultant advantages to the trading public would be that the incidence of duty the level of which at present is so high as to make a substantial factor, would be relatively less and a slight loss to the Revenue would be counter-balanced by the greater ease and simplicity of administration and a more cordial relationship between the tax-payer and the revenue. Another incidental advantage would be that the opportunities for corruption of appraising staff would be greatly minimised. It is true that there is some danger of the importer and the supplier abroad colluding together by manipulating invoices but this should not be a difficult matter to curb both at the consulate end and at the destination end by the Customs authorities. With foreign exchange control, as is in force, such a practice is not easy. The fear of loss of market for the foreign exporter and the fear of confiscation of the goods and a heavy fine for the Indian importer should dissuade any attempt at collusion. Moreover Customs authorities have sufficient data with them about prevalent world prices for most categories of goods that it would be almost impossible to deceive them by means of an under-invoice. Further, with the introduction of a system of Consular Invoices, the grievance of the trading public that the Customs authorities now choose such one of the two alternative basis provided in Section 30 which will yield more revenue would have been removed. For instance, supposing that since the date of shipment there has been a fall in prices and as a result the invoice value is higher while local wholesale values for imports made after the fall in prices is lower, the Customs may take the view that the local wholesale market value is either not available or reliable and choose Section 30(b) basis which would be more advantageous to the Revenue. In a converse case where the trend is for prices to rise, Customs may adopt Section 30(a) basis, so that whatever happens, the revenue ensures that it has the best of the situation. In a recent case which went up to the Punjab High Court, the facts were that a consignment of six wagons of dry fruits was on arrival assessed to duty under Section 30(b); sometime later, it was discovered by the Customs authorities that duty had been erroneously assessed under Section 30(b) whereas it should have been assessed under Section (a); a reassessment was made under Section 30(a) and a supplementary demand for more duty was made upon the importer. It was claimed that under Section 39 of the Sea Customs Act, Government had the power to correct an error in assessment, such as on one basis to another. With a system of consular invoices duty will be assessed on the value as shown in the invoice *plus* the charges until landing and there will be no occasion for the Custom authorities and the importer disagreeing about what is the correct local wholesale market value.

(ii) Evasion by undervaluation is just a bogey; our Customs authorities are too alert to be taken in by any such crude device.

The introduction of a system of consular invoices as suggested above is commended for the Commission's consideration.

Question 108.—(ii) Under the four-point anti-inflationary policy, set in motion in November 1948, relief from Customs duties was given to imports of raw materials and plant and machinery for a term. If in the interests of industrialisation it is felt that a concession of this nature is desirable, a similar concession may be given temporarily.

(B) If it can be ensured that goods ostensibly imported for humanitarian and charitable purposes will be actually used for such purposes and not be diverted or that the charitable or humanitarian purpose is not interposed merely as a subterfuge to get the benefit of the reduction to the extent of the duty, an exemption from duty is not objected to.

(5) It is not considered that, save certain drugs and medicines, there are any necessities of the life of the Indian population which cannot be met from home sources and which require to be imported. In the case of such drugs, where the use is by public hospitals or State Medical Departments, an exemption may be granted.

Question 110.—Customs duties should, in our view, never be used as an instrument to restrict the quantity of imports of any particular class of goods for the reason that it would constitute a gratuitous present to the Indian manufacturer to the extent of the further duty, that is, raise the price of the home product merely because Government either gets a higher revenue from the imported goods or maintains the same revenue from a smaller volume of imports. It is a most insidious weapon when already industrial profits are disproportionately high when compared with rewards available from other activities.

Question 112.—The present provisions in the Sea Customs Act relating to appeals are contained in Sections 188 and 191. An appeal lies to the Central Board of Revenue against the order of the Collector and a revision application may be made to the Central Government from the order of the Central Board of Revenue. It has long been a public grievance that appeals to a judicial authority are not available under the Sea Customs Act as under most other Tax Acts and that the so-called appeals are only from the lower officers of the Department to the higher. An *obiter dictum* by their Lordships of the Calcutta High Court in a recent case under the Sea Customs Act may be of interest. "These appeals and revisions are in the nature of appeals from Caesar to Caesar and might not be regarded with any great confidence by persons in the position of respondents in this case." Whether it is justifiable to entertain such a view or not, the public may have a feeling that the Board almost invariably support a finding of the lower officers and such an impression could only be removed by providing an appeal to an independent judicial authority. Some months ago a private bill to amend the Sea Customs Act with this object was introduced but it would appear that it lapsed as it failed to secure a ballot.

However, it would appear that a decision of the Board or of the Government is challengeable under Article 226 of the Constitution. In the case of *Assistant Collector of Customs v. Sooraj Mal* (1952) their Lordships of the Calcutta High Court observed: "The right to apply to the High Court for a prerogative writ is given by Article 226 of the Constitution and it appears to me that that right cannot be taken away by any statute because if it was, the Courts would be bound to hold such a statute *ultra vires* Article 226. Further it might well be contended that no statute could impose any restriction on the right to ask the High Court for a prerogative writ."

However, it does seem a relic of bureaucratic methods to give the executive powers to exercise judicial functions also. It may be considered if appellate authorities as under the Income-Tax Act cannot be provided for under the Sea Customs Act to hear and decide cases under the Act.

Question 116.—There may legitimately be some public criticism of Government's administration of commercial undertakings which certainly has not been invariably as efficient as one would wish. But it must be conceded that it is a new function which Government have been called upon to undertake in the public interest and some time must be given to them to adjust themselves to the new situation. Some of the recommendations of the State Trading Committee are worth notice in this connection. As regards import trade, the Committee believed that over a large part, the balance of advantage would lie in leaving the field to private enterprise but they thought that certain luxuries whose prices remain high and where the element of commercial risk is small, such as in the case of certain types of vehicles, State trading may be tried. So also in regard to certain branches of import trade which are now undertaken by the State, such as foodgrains, fertilisers and East African raw cotton, the trading activity may be continued wherever necessary. The Committee suggested that the position regarding jute manufactures, coal, shellac, mica, tea, manganese ore, short staple cotton and sugar as possible subjects of State trading be investigated. The Government of India has recently imported sugar for public consumption. Some other commodities suggested for State import or export were heavy chemicals, wattle bark, arecanuts and cocoanuts. The constitution of statutory corporations to undertake State trading was recommended. The majority of shareholding in the Corporations was to be by the Central Government, the balance being offered to State Governments and private investment.

In the public interest and in order that the Consolidated Fund of India may not, in the attempt to provide further revenues, be saddled with losses of State trading, a great deal of caution would be necessary before venturing on any particular scheme of State trading. However with some training of Government personnel and with some borrowing of personnel from the business community as was done in the war years to run a number of departments in the Supply organisation, it should be possible to organise these trading undertakings on a proper basis.

Question 122.—Cesses are now levied on a number of commodities generally at the time of export to provide a fund for research, improvements in grading and quality or for better methods of marketing. Such commodities which now suffer a levy of cess are tea, jute, ginned cotton, coffee, hides, oil cakes, pulses, spices, tobacco, wool, etc. It is not considered that a part of the export duty need be diverted for such purposes as cesses have been found to be a very satisfactory instrument in the past for providing finance for such purposes.

Question 125.—(i) As long as the State Legislatures are, under the present constitutional allocation of revenue sources, competent only to impose a tax on the sale or purchase of goods, the question of taxing services such as those mentioned in the question does not arise. At present, transactions which involve sales of goods and giving of services are dealt with by introducing a fiction that each part of the transaction represents an assumed definite portion of the entire sale price. This notional apportionment between goods and services is typified by Rule 28 of the Delhi Sales Tax Rules which is in the following terms:—

"In computing the sale price for the carrying out of any such contract, as is referred to in sub-clause (i) of clause (b) of Section 2, a dealer may deduct from the amount payable to him as sale price for the carrying out of any contract:—

- (i) in the case where the registered dealer produces to the satisfaction of the appropriate assessing authority evidence showing the cost of materials and the cost of labour used in respect of such contract, the sum obtained by multiplying the amount so payable by $\frac{x}{x+y}$ where x is the cost of materials used in the construction of the contract and y is the cost of labour employed.
- (ii) in other cases the following percentages of the amount payable, namely:—
 - (a) in the case of an electrical contract—20 per cent.
 - (b) in the case of a structural contract—30 per cent.
 - (c) in the case of a sanitary or gas contract—33-1/3 per cent.
 - (d) in the case of overhaul or repair of any motor vehicles—60 per cent.

This is a rough and ready basis aimed at convenience of assessment rather than of an equitable apportionment on any logical or sound basis. It may be supposed that even if a contractor kept very full accounts of contracts falling within the second category showing how much the materials cost and what is the labour charge, he would not be able to vary the statutory rule in his favour.

If the Constitution could be modified to give power to the States to tax sales of services also, then State Governments would be in a position to enlarge their revenue out of sales taxes. In the United States of America, where among the constituent States, sales tax takes numerous forms; such as Privilege Tax, Gross Receipts or Proceeds Tax, Gross Income Tax, these taxes have a broader scope than a sales tax on goods only. It may be recalled that the Planning Commission, while suggesting possible ways of increasing State revenues recommended that Sales Taxes be extended to have a wider coverage. If this recommendation were to be implemented, it follows that Sales Taxes should be extended to have wider application than at present, not only to more goods but to services also.

(ii) As regards sales taxes on transactions effected in Stock Exchanges, it may be noted that Dr. P. J. Thomas in his report on the Regulation of Stock Exchanges suggested that the main legislation to be undertaken by the Central Government should include conferment of powers on the Central Government to, among others, levy a sales tax on the sales of securities, principally for raising funds essential for meeting the cost of such regulation. Dr. Thomas could not at the time have anticipated what the constitutional position would be and how his suggestion would be affected.

However, according to the definition of the term 'goods' in the Sale of Goods Act, goods include stocks and shares. It would appear from Entry 54, List II of the Seventh Schedule to the Constitution that it would be competent for the State Governments to levy a tax on the 'sale or purchase of goods other than newspapers' but note should be taken of the fact that according to List I, Entry 90 "taxes other than Stamp Duties on transactions in Stock Exchanges and Futures Markets" are a Union subject. There must be some doubt whether the word 'taxes' in this entry would include all taxes including sales taxes. On the other hand Entry 92 in List I would appear to entitle the Central Government to impose a Sales Tax only on newspapers. If this constitutional uncertainty could be clarified or resolved and the issue settled as to which Government is competent to tax transactions of sale or

purchase of stocks and shares, then it would be possible to think of bringing these transactions under Sales Tax. Assuming that the constitutional difficulty is solved, there is no reason why the sale and purchase of stocks and shares should not be made liable to sales tax, just as other goods and services. It will be just another tax on transfers in addition to the Stamp Duty. An additional Sales Tax may be justified on the ground that in most sales and purchases a speculative element enters.

Question 126.—(i) The question whether sale of current newspapers should not be treated on the analogy of the exemption from customs duty given to books and current newspapers deserves consideration. A tax on books is a tax on knowledge and rightly, therefore, the Central Government have not thought it proper to subject books to a customs duty. A tax on newspapers would be a tax on information and knowledge and if an intelligent democracy is to be helped to come into being, it would appear that the greatest possible encouragement should be given to newspapers particularly in the direction of exemption from tax. Further, under the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act passed last year, "Books, exercise books and periodical journals" have been declared to be "goods essential to the life of the community" and under Section 3 of that Act any tax imposed by a State legislature on the sale or purchase of any essential goods after the coming into force of that Act will have effect and validity only if the measure has been reserved for the consideration of the President and has received his assent. It is to be considered whether when such a restriction has been placed on State Governments in respect of books and periodicals, the Central Government should have the right to tax the sale or purchase of newspapers. It seems to us that newspapers are not a proper subject for Sales Tax.

Tax on newspaper advertisements (a tax on advertisements other than advertisements published in newspapers is a State subject) does not also appear to be a suitable subject for sales taxation by the Central Government. A tax would mean heavier rates of advertisement which may result in a fall in advertisement income to newspapers. In any case it is felt that whether a tax is imposed or not on newspaper advertisements, advertisements in periodical journals should certainly be exempt as in many cases the advertisement revenue is inconsiderable and as a good number of them are by no means in a prosperous position commercially.

Question 127.—In strict theory and in an academic view of the matter, the view propounded in the question would seemingly oversimplify the enormously complex question of tax. But on a practical view its simplicity is deceptive and the suggestion is unworkable under the present constitutional provisions and as these taxes have been looked upon and treated over a long period of history.

Excise Duty and Sales Tax have no affinity between them. Their different characteristics may best be described in the words of two judicial decisions, one of the Federal Court and the other of the Privy Council. In the Province of Madras *v. B. Paidanna & Sons*, their Lordships of the Federal Court observed:—

"The tax on the sale of goods which the (Government of India) Act assigns exclusively to provincial legislatures is a tax levied on the occasion of the sale of goods. A tax levied on the first sale must in the nature of things be a tax on the sale by the manufacturer or producer; it is levied upon him *qua* seller and not *qua* manufacturer or producer. It may well be that a manufacturer or producer is doubly hit. If the tax-payer who pays a sales tax is also a manufacturer or producer of commodities subject to a Central duty of excise, there may no doubt be overlapping in one sense; but there is no overlapping in law. The two taxes which he is called upon to pay are *economically* two separate and distinct imposts. There is in theory nothing to prevent the Central legislature from imposing a duty of excise on a commodity as soon as it comes into existence, no matter what happens to it afterwards, whether it be sold, consumed, destroyed or given away. In the case of a sales tax the liability to tax arises on the occasion of a sale and a sale has no necessary connection with manufacture or production. The manufacturer or producer cannot of course sell his commodity unless he has first manufactured or produced it; but he is liable if at all to a sales tax because he sells and not because he manufactures or produces and he would be free from liability if he chose to give away everything which came from his factory."

In another case, Governor General in Council *v. Province of Madras*, the Privy Council observed: "A duty of excise is primarily a duty levied on a manufacturer or producer in respect of the commodity manufactured or produced. It is a tax upon the goods and not upon the sales or proceeds of sale of goods. In law there is no overlapping. The taxes are distinct and separate imposts. If in fact they overlap, that may be because the taxing authority imposing a duty of excise

finds it convenient to impose that duty at the moment when the excisable article leaves the factory or workshop for the first time upon the occasion of its sale. But that method of collecting the tax is an accident of administration; it is not of the essence of the duty of excise, which is attracted by the manufacture itself."

To our knowledge, the over-simplification assumed in the question of merging sales taxes in either Customs Duties or Excise Duties has not been attempted in any country. Unlike in India, for instance, sales tax in Australia is a Commonwealth tax or Federal tax levied separately by the Customs on imported goods and from manufacturers and wholesale merchants by Commissioners of Sales Tax. In Canada also where Sales Tax is a Dominion source of revenue, the tax is levied separately from the importer on imported goods and from the manufacturer when the goods are manufactured in Canada at the time when goods are delivered to the purchaser. This will show that neither of these countries has considered it unnecessary to have a sales tax because, it has no function to fulfil in the tax structure. On the other hand Sales Tax being a Commonwealth or Dominion source of revenue, unlike in India where it is a State source, it would have been easier for them to merge it into customs and excise duties. It would not be correct to say that in India sales tax has no function to fulfil in the tax structure; it now yields about Rs. 60 crores of State revenues; it may perhaps yield as much if it were merged in Central taxes such as Customs duties or excise assuming that the State Governments will agree to such a step but all sorts of difficult questions regarding allocation in a manner acceptable and satisfactory to the States, would arise.

An octroi or terminal tax is doubtless a tax on entry of goods but as commonly understood and as hitherto uniformly applied in the country, it signifies only a tax imposed on entry of goods into a local area; that is, municipal or corporation limits. The present constitutional position is that Entry 52 of List II of the Seventh Schedule is in the following terms: "taxes on entry of goods into a local area for consumption, use or sale therein". We doubt if it will be a practical proposition, even if the Constitution were amended to enable the State Government to exercise the power of applying what is a local tax as a State tax for the State Governments to levy a tax on entry of goods into their area by road, rail, sea or air at all points of ingress; there would be difficulty too about the treatment to be accorded to passing or transit traffic through one or more States. So far as municipal terminal taxes are concerned, there is generally no refund on export of imported goods. The suggestion made in the question is not so simple as it would appear on the surface. The third suggestion of merging sales tax into Customs Duty is no less impracticable. We would point out only a few of the practical difficulties that would arise. Supposing a surcharge, proceeds of which are distributable to the States to represent the Sales Tax, is to be added to the Customs Duties. Firstly, separate account will have to be kept for the Customs duty revenue and for the surcharge representing sales taxes. A basis of apportionment will have to be decided. Any one familiar with the distribution to the States of part of the proceeds of income-tax would know that from the time of Sir Otto Neimeyer's formula, and at each successive re-adjustment such as the Deshmukh Award, the Finance Commission's decision, there has been considerable dissatisfaction among the States. Suppose that in the event of a Central surcharge on customs or excise duties, representing sales taxes being possible, goods are landed at Bombay and Customs duty and surcharge are collected. Part of the goods may be meant for consumption in Bombay and the rest in other provinces in various proportions. How would the destination end of the goods be ascertained, how would the quantum of consumption in the several States be determined or on what other basis would allocations of the revenue be made to the States?

The suggestions in the question would need the scrapping of the whole of Schedule Seven and the articles relating to it in the Constitution, a system which has been in force more or less in that form under the Government of India Acts, 1919 and 1935. It seems to us to be so purposelessly academic that it does not appear to be worth serious investigation. It would imply and assume that it is possible to put the clock of Indian political Constitution and of autonomous institutions back to say 1890, when India was a strictly unitary State, all the revenue being under the disposal of the Secretary of State for India and all the authorisations of expenditure being under his discretion; it would abrogate the very first Article of the Constitution which has been laboriously evolved that India is a Union of States; that is, States not completely subordinate; but having a fair measure of autonomy. It would mean that just to satisfy an economic fad, we should be prepared to ignore the history of the last fifty or sixty years.

The legitimate function of an excise duty is to tax production or manufacture; that of customs to tax goods on entry into India from abroad or export from India to foreign countries; that of an octroi or terminal tax to tax goods entering local or town limits. The legitimate

function of a sales tax is to tax sales or proceeds of sale. These taxes have been so understood here as well as in other countries.

Far from Sales Tax not having a useful function to fulfil in the tax structure of the States, it was seriously suggested some years ago that the Federal Government in the U. S. A. should introduce a sales tax as a part substitute for income-tax on lower grades whereby it was thought that about ten million income-tax assessees could be removed from the category of income-tax assessees and the administration of that tax lightened to that extent. Sales Tax is a tax very easy and inexpensive to administer. Pursuing the question in its logical sequence it would seem that a one-tax fiscal system, an all comprehensive 'means tax' would be, academically, even simpler, were it practical. A doctrinaire approach to such a matter is seldom feasible and the wider diversification of taxes, the greater is the balance imparted to the tax structure.

Question 128.—(a) The view put forward in the question is agreed to and from the nature of things it must be so, unless it is made compulsory for certain minimum accounts to be maintained in the form prescribed by the State as is done in some continental countries. No other method than that now adopted by the States generally is feasible as a practical proposition. In theory, the aggregate turnover represents the collective figure of individual sale prices. In law the sales tax is due immediately the sale takes place but the revenue defers collecting it until the end of the quarter.

(b) In some States, before a General Sales Tax Act was considered practicable, an experiment was made with particular commodities, and petrol and lubricants were singled out as being in the 'luxury' class and as being convenient for collection because of the system of distribution applying to them. This is merely a matter of historical accident and the sales tax on an individual commodity, be it petrol or be it tobacco, was merely the fore-runner of the general sales tax which was to apply to most goods in consumption and which was to follow. The separate sales tax pertaining to petrol in some States, may well be extended to other luxury articles but no useful purpose would appear to be served by having separate legislation. The object could as well be achieved by imposing a higher rate on luxury articles under a general sales tax system which some of the States even now do.

Question 129.—The history of the Sales Tax Act in the Punjab is an illuminating commentary on the merits and demerits of the respective types of taxes. The original 1941 Act imposed a tax at all stages (what under the question is referred to as a multipoint tax) at the rate of annas 3 per cent. for turn overs exceeding Rs. 10,000 but not exceeding Rs. 20,000 and at 4 annas per cent. on turnovers exceeding Rs. 20,000. These were admittedly very low rates of tax and in 1948 when the need for additional revenue became urgent Government proposed that the rate of tax should be raised to Rs. 1/9 per cent. at all stages. The trading community in the State protested vehemently against this proposal on the ground that this would in fact work out to the consumer at a tax of Rs. 6/4 per cent., since normally there are four stages in the movement of goods from the importer, producer or manufacturer to the consumer, namely, firstly from the producer, importer or manufacturer to the wholesaler, secondly from the wholesaler to the sub-wholesaler, thirdly from the sub-wholesaler to the retailer and fourthly from the retailer to the consumer.

The traders' alternative proposal to Government was the introduction of a one stage tax on the lines of the Bengal Sales Tax Act. Accordingly a new piece of legislation was enacted introducing a one-stage sales tax, at the stage when a registered dealer sells goods to an unregistered dealer or consumer and the rate of tax for this one-stage tax was fixed at Rs. 3/2 per cent.

There was opposition from the trading community to this measure also. And even among the trading community there was difference of opinion on the question of at what level the one stage tax should be levied. The importers, manufacturers and producers recommended tax being levied at the retail stage and the retail merchants suggested that the tax should be at the importers', producers' or manufacturers' stage as it would be easier to collect the tax at source and as more reliable accounts were likely to be kept by them than by the retailers. Government selected the retail stage for the following reasons, firstly that the Government of India had issued a directive to the States that Sales Tax should take the form of a one stage tax and the stage to be the retailer-consumer stage, secondly, if a stage other than the retailer-consumer stage were selected, stocks then with retailers would escape tax and thirdly that sale price at the first stage of descent of the goods would not include the retailers' profit and therefore the tax collected at the highest level would be about 20 per cent. less than that at the retailers' level. It may be mentioned that under the Canadian and Australian legislation where sales tax is a federal source of revenue, the tax is levied at the highest level, namely,

importer, producer or manufacturer presumably on grounds of convenience and efficiency of tax collection. But in the United States of America, where Sales Tax is a State tax, the tax is generally levied at the retailer-consumer stage.

A tax on the stage lower down would naturally yield a larger revenue than at a stage higher up as in the price the profit of the merchant above is included. But while from the point of view of the Revenue a tax at the lowest stage yields a larger revenue than at the source of importer, producer or manufacturer, the impact on the trade of a tax on a stage high up in the descent of the goods to the consumer becomes incorporated in the price at all levels of the goods and raises the cost of stock-laying, stock renewal and insurance and thus may pose a bigger financial problem to the trade.

Even this new legislation was not acceptable to the trading community of the Punjab. They agitated for the restoration of the old multi-stage tax; if this was not possible, they demanded that the new legislation should be amended in a number of directions, among which one was that assessment should be on the basis of purchases by the dealer and not on the basis of sales made by him. As the Punjab Government pointed out, it would have meant allowing the dealer to collect sales tax from the Customer on the basis of the sale price, while the tax paid to Government would have been on his purchase price which would result in a smaller figure of tax revenue.

As between a single-stage tax and multi-stage tax the multi-point system would appear to have more advantages. The system has been in force for many years in Madras and perhaps also Mysore, Travancore-Cochin, and lately in Hyderabad which are States which, relatively to other States in India, have the poorest populations. If they have tolerated the system, although under occasional feeble protest, it may be assumed to be good for the rest of India where the people are comparatively more prosperous.

It may be opportune here to point out that the popular conceptions about the multi-point tax having a more onerous incidence does not appear to be correct provided that the scale is relatively proportionate. The Bombay Sales Tax Enquiry Committee, 1946, stated that a number of trade organisations had expressed preference to this system and the Committee also by a majority recommended the substitution of the then prevalent single point system by this multi-stage levy. Their reasons for making this recommendation as given in their report, may be summarised thus:

The majority of the Committee considered what the objections generally raised against multi-stage sales tax were and whether they were valid:—

1. The multi-stage tax involves taxation at each stage the goods change hands. The majority of the Committee found nothing intrinsically wrong in taxing an article at each stage instead of at one provided the total incidence of the tax is not greater under this system than under the other. The Committee explained that multiple taxation is not double taxation and that whereas in the single-stage system the burden of the tax is imposed at one particular stage, under the multiple stage system it is so divided that a part of it is borne each time the commodity changes hands.
2. The incidence in a multi-stage tax varies from commodity to commodity because all of them do not pass through the same number of hands in their movement to the consumer. This, the Committee thought, was not necessarily unjust and in their view the number of times that a commodity changes hands is indicative of the amount of trading and transport charges that the consumer is able to bear and the Committee considered that it could be fairly argued that taxation which is related to the number of occasions of trading conforms to economic facts better than the single stage system.

The Committee rejected the argument that the burden of the multi-stage tax will be larger on the commodities consumed by the poorer classes than on those consumed by the richer for they considered that where produce locally made was dealt in, the incidence would be much less than that of the single-stage tax. The Committee agreed that such commodities as are more traded in will be taxed correspondingly more in the multi-stage system but they felt that that could not justify the presumption that a multi-stage tax imposes a heavier burden on the poorer classes.

3. Referring to the objection that a multi-stage tax, in the cases of a manufacturer would be imbedded in the cost of production and would make the price of the manufactured goods high, the Committee pointed out that whatever the system the final price of the goods to the consumer would be the same under both systems for in the single-stage tax, the tax will be added at the last stage of passing to

the consumer while in the other case, part of the tax would be incorporated in the price at the earlier stages.

4. A merit claimed for the single-stage consumer end tax, is that the consumer definitely knows what tax he has to pay and is able to resist an illegal charge and has a clear knowledge of the incidence of the tax. This claim the Committee found was not borne out by the single-stage tax then in force in Bombay. On the other hand the Committee were disposed to regard as a merit of the multi-stage system that its incidence being small at each stage, there was more likelihood of its being absorbed in appropriate circumstances by the dealer.

The Committee's general conclusion was that provided the total revenue receipts derived from either system were about the same, the administrative and other advantages of the multi-stage system were very large. They further found that a small multi-stage tax provided less incentive to evasion and also less incentive actively to bring about changes in the pattern of trading structure.

A further distinction which may be noted is that a consolidated single-stage tax as distinguished from a light multi-stage tax, is a 'high visibility' tax. This fact was doubtless the cause of the long-drawn out agitation of the trading community in the Punjab. This fact further appears now to have been seized upon with advantage by political opposition parties to stir up public agitation against the Government as recent happenings in Assam show.

Question 129.—(i) To our knowledge there are no data which would enable us to come into any definite conclusion on the point whether a greater burden is placed on the consumer than is accounted for by the revenue from the tax.

(ii) The form of accounts to be maintained by the dealers is prescribed under the rules framed under the several Acts. If the accounts are to be simplified, one must choose either to make the maintenance of accounts very simple and unburdensome to the dealer and sacrifice revenue or require detailed accounts to be kept which in many cases due to illiteracy of dealers, if the tax is at the last stage, may not be complied with and which would enable the Revenue, to assess on estimate and help to get a larger tax revenue, although in some cases it may involve a hardship.

In the case of Sales Taxes levied at one stage, the tax is payable by the dealer who is permitted to reimburse himself by collecting the tax from his several customers. The dealer is really not an assessee but is the Government's agent for collecting tax from his customers, the consumers, and making it over to Government. A dealer or a dealer's staff spend time and effort on the collection of tax and on the making of returns periodically and to that extent the dealer is put to expenses on Government account. To the State, the sales tax is for that reason a very inexpensive tax to collect. In some States of the United States of America it would appear that the dealer is allowed to retain for himself a small percentage of the tax payable by way of compensation for the time and labour he has to give and for the expense he is put to on this account.

Question 130.—(i) There really would be a three tier tax; a low one on goods scheduled under the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act, as essential for the life of the community.

(ii) A normal or standard rate which is a relatively higher rate on non-essential goods as above but lower than the higher rate on the next category of 'luxuries'.

(iii) A relatively still higher rate on articles to be classed as 'luxuries'.

There need be complete exemption only for the few necessities consumed by the poorer classes if revenue considerations will permit. Although the incidence of a flat rate of Sales Tax is admittedly regressive and offends the basic principle of 'ability to bear', this theoretical objection would largely disappear with a graded tax where some necessities consumed by the poor are exempt, where the standard rate is moderate and where luxuries bear the high tax appropriate to them. When in place of a small flat rate tax, there is introduced a graded system and in the higher stages the tax is a heavy one some complicated problems which may face trade and industry will call for consideration, as they did in the case of the Purchase Tax in the United Kingdom. In July 1951, the Chancellor of the Exchequer appointed a Committee with the following terms of reference:

"To review the present position of the Purchase tax affecting those classes of goods within which utility schemes operate (i.e., cloth, garments, footwear, household furnishing textiles, furniture and bedding) (utility scheme goods are exempt from Purchase Tax) in relation to international agreements bearing on the internal taxation of imported goods and to the interests of the export trade, consumers and manufacturers, to consider possible

adjustments of that system with a view to removing or reducing any difficulties to which it gives rise; and to submit recommendations on these matters having due regard to the need to maintain the advantage of the utility schemes to consumers, the expansion of the export trade and the yield of the Purchase Tax revenue which would accrue under the existing arrangements from the classes of goods in question."

A serious inherent defect of the Purchase Tax utility arrangements pointed out by the Committee was the virtual absence of a range of goods immediately above the top utility prices. To quote the report in explanation: "This blind spot is caused by the sudden jump from tax exemption to tax on the full wholesale value of the goods. For instance assuming the maximum wholesale price of a utility shirt to be 20sh., a shirt valued 21sh. would under the present arrangements bear a tax of 7sh. making a wholesale price of 28sh. including tax. Except where there is an extreme shortage of utility goods, nobody will pay 8sh. to get 1sh. worth of extra quality. It is not until a point well above top utility qualities is reached that the additional cost (including tax) appears to the consumer sufficiently commensurate with the additional quality to enable the goods to find a market. . . . The existence of the 'blind spot' obviously places the main burden of providing revenue from these classes of goods on to a relatively small range of high-grade goods."

The Committee came to the interim conclusion that "the adjustments required in the Purchase Tax system should as far as possible take account of the need to—

- remove the tax discrimination against imported goods;
- maintain the tax exemption for lower priced goods;
- remove the 'blind spot';
- reduce the tax differential between non-utility and the highest priced tax-free utility goods;
- avoid competition between closely competing goods of equivalent value."

The Committee's suggestion for exempting cheaper goods from Purchase Tax without creating sudden disproportionate jumps in the amount of tax payable "is by charging tax on y on the excess, if any, of the value of the article over the tax-free limit which would be expressed as a fixed deduction (which we call D for short) for the value for tax purposes of both utility and non-utility goods. Under this system, supposing D for shirts to be fixed at 20sh. the 21sh. shirt cited above would be chargeable with tax (at 33 1/3 per cent.) only on the excess of its value (1sh.) over D; i.e., it would bear a tax of 4d. instead of 7sh. Similarly a 40 sh. shirt would be chargeable with 6sh. 8d. (33 1/3 per cent. levied on 40sh. minus 20sh.) instead of 13sh. 4d. as at present. This is the principle underlying the income-tax, which is chargeable only on net income after deduction of statutory allowances."

The Committee's final conclusions were that the benefits which a D scheme would bring to the export trade, consumers and industry would fully justify its adoption in place of the existing Purchase Tax/Utility arrangements and recommended *inter alia* :—

- that the present exemption from Purchase Tax of utility goods be replaced by a system of deductions from wholesale value applying to utility and non-utility goods alike; and
- that Purchase Tax at present rates (which range from 16 2/3 per cent. to 100 per cent.) be charged on the excess (if any) of the actual value of the goods over the appropriate deductions."

Question 131.—A certain measure of uniformity in tax schedules and rates can be achieved through the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act; if it can be enforced in respect of all Sales Tax Acts in the States. Beyond that, however, an all India uniformity would appear to be attainable and also undesirable to attempt. On the surface it looks an attractive proposition but the State legislatures must be presumed to know the taxable capacity of their people and how best it could be exploited and any interference with the State's powers which must necessarily lead to a fall in the revenues to be derived from Sales Tax is likely to be resisted by the States.

Question 132.—One might say with regard to this Act that except on paper there is no uniformity in the matter of either exemption or of the introduction of a low rate of tax. But it is not to be supposed that Government are to be blamed entirely. Article 286(3) of the Constitution impliedly required that Parliament should pass a law declaring what goods shall be deemed to be essential for the life of the community. This was done by the Essential Goods (Declaration and Regulation of Tax on Sale or Purchase) Act, the Schedule attached to which specifies the goods which Parliament has declared to be essential for the life of the community. Section 3 of this Act is to the effect "No law made after the com-

necessement of this Act by the Legislature of a State imposing or authorising the imposition of a tax on the sale or purchase of any goods declared by this Act to be essential for the life of the community shall have effect unless it has been reserved for the consideration of the President and has received his assent". This section has been interpreted to mean that it is only when a State after the coming into force of this Act imposes a tax for the first time on these essential goods or when a State seeks to raise a tax on these essential goods which has already been in force, that the procedure prescribed in the Section should be conformed to. It follows, therefore, that where a State has already been levying a tax on these essential goods and does not propose to make an increase such tax will continue to be in force without any constitutional hindrance. This view would appear to be supported by Article 227 of the Constitution under which all taxes, duties, etc., lawfully levied before the commencement of the Constitution may continue to be levied notwithstanding that they are mentioned in the Union List or presumably subject to any Union Legislation. So it is that the legislation in respect of goods essential for the life of the community cannot have any retrospective effect. This circumstance makes the Act a thoroughly purposeless piece of legislation because in actual practice most States of the Indian Union had a sales tax in their fiscal systems before it came into force. The intention of the Constituent Assembly when enacting Article 286(3) is obviously unmistakable. It sought to provide that in respect of articles which are essential to the life of the community, States should not impose a sales tax or if they did, impose only a light scale of tax. If in respect of Sales Tax Acts in force from before the commencement of the Constitution, amendments can be made to give effect to the intention of the framers of the Constitution and tax rates reduced, it would be a desirable consummation.

Question 133.—(a) With the interpretation by the Supreme Court in the case of *State of Bombay v. United Motors Ltd.*, of the provision in Article 286 relating to inter-State trade, it is only the consuming State that will now be entitled to levy a sales tax on inter-State trade. The principle of the judgement that it is the consuming State that is entitled to impose the Sales Tax, which really is a tax on consumption is obviously the correct one; the logical corollary to this decision is that it makes a trader entering inter-State trade liable to pay the sales tax to the consuming State on his sales therein. If he happens to sell goods to a number of States, he may find himself in the unenviable position of having to file returns with each State authority and it may happen that he is required to produce books simultaneously by a number of States. This would involve a definite hardship to the trade.

This same problem which arose in the United States was settled by the Supreme Court validating the States' right to impose a Use Tax on a resident of a State making his purchases outside the State. The Sales Tax reaches all inter-State taxable sales, and the Use Tax reaches all sales inside the State by dealers outside it. In a typical Use Tax legislation, the rates of tax are just the same as the rates in force for Sales Tax as this is merely a compensating tax and the obligation is placed upon the purchaser who makes his purchases from sources of supply outside the State to file a return and pay the tax to the Collector within, say, twenty days after the end of each calendar month.

If the States in India supplement their Sales Tax Acts with a Use Tax, the question of the State Tax authorities' going outside the jurisdiction of the State will not arise. If a dealer sells goods in inter-State trade, the purchaser would become liable to pay the tax due to his State of residence.

(b) This question is not fully understood. It is only one transaction of a transfer of goods for consideration in money which constitutes a sale from the point of view of the seller and of purchase from that of the purchaser. If it is meant that instead of the tax being payable by the seller, it should be made payable by the purchaser, administratively it would be difficult to deal with a body consisting of an immense number whereas a tax payable by the sellers is easily collected from a relatively much smaller body. In the United Kingdom the tax, although called the Purchase Tax (imposed by Finance (No. 2) Act, 3 and 4 Geoc. 48) is really a tax

on the seller and Section 18(3) of that Act is in the following terms: "Tax chargeable in respect of any goods by virtue of a purchase shall become due on the delivery of the goods under the purchase and the seller under the purchase shall be accountable therefor."

Under the American system, consisting of a Sales Tax on dealers and a Use Tax on purchasers who make purchases outside the State, the tax jurisdiction of each State is confined to parties within its own territorial limits. Under this system, transactions would be taxed as sales in a majority of cases and as purchases in a few cases. The two categories may be defined thus, as they have been in American State Acts. We take the example of the District of Columbia Sales Tax Act (Public Law 76, H. R. 3704, May 27, 1949), as being among the latest enactments: The charging Section 125 is in the following terms:—

"Imposition of Tax. Beginning on and after the first day of the first month succeeding the sixtieth day after approval of this Act, for the privilege of selling certain tangible personal property at retail sale and for the privilege of selling certain selected services defined as sales at retail in this title, a tax is hereby imposed on all vendors at the rate of two per cent. of gross receipts of any vendor from the sale of such tangible personal property and services."

The charging section under the 'Compensating Use Tax Act' provides:—

S. 212. "Beginning on and after the first day of the first month succeeding the sixtieth day after the approval of this Act, there is hereby imposed and there shall be paid by every vendor *engaging in business* in the District (which means making sales in the District) and by every purchaser a tax on the use, storage or consumption of any tangible personal property and services sold or purchased at retail sale. The tax hereby imposed shall be at the rate of 2 per cent. of the sales price of the tangible personal property or services rendered or sold."

Under this Act, there is provision also for certain approved outside vendors collecting tax from the purchaser at the prescribed rate and paying it to the Collector.

S. 214. "Every vendor or retailer not engaging in business in the District who makes sales at retail as defined in this title and who upon application to the Collector has been expressly authorised to pay the tax imposed by this title shall at the time of making such sales collect and give the purchaser a receipt therefor in such form as prescribed by the assessor A permit shall be issued to such vendor or retailer without charge to pay the tax and collect the reimbursement thereof as provided herein. Such permit may be revoked at any time by the Collector who shall thereupon give notice thereof to the vendor or retailer."

If a dealer who is outside the State desires to have a market in it, he can be authorised to collect sales tax due on a sale made by him to a person in the State and to pay it to the States sales tax authorities. Under such a system the State's jurisdiction outside its territories is not imposed on anyone but it is willingly accepted by the dealer outside the State in consideration of benefits he would receive by trading. Dealers outside the State under a system such as this will not be under compulsion to account for all the States where they sell their goods and normally the responsibility is that of the purchaser. The question of any hardship to the trade by its being held accountable to numerous outside States would not arise.

In inter-State trade, it is only the consuming State that is entitled to levy a sales tax. We do not see why this one consumer State tax, whatever its rate or method of application, should act as a barrier to inter-State trade. If, as before the Constitution, more than one State laid claims to tax inter-State trade, such as the State where the contract of sale was made, the State in which the goods were physically situated and the State where delivery was made for consumption, one can understand the obstacles to inter-State trade but with the present provision in the Constitution and the Supreme Court's authoritative interpretation that it is only the consuming State that is entitled to levy a sales tax, there should, it seems, be no question of impediments or barriers to inter-State trade.